Annual Healthcare M&A Report 2022

2021 Trends & 2022 Expectations

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Healthcare M&A Report

2021 Trends and 2022 Expectations

Healthcare Mergers and Acquisition ("M&A") activity returned in full force in 2021 amidst a broad economic recovery, even as the healthcare industry continued to respond to the evolving COVID-19 pandemic. In 2021, healthcare M&A volume and value both exceeded pre-pandemic levels. The main catalyst for transactions continued to be a focus on building scale and cost efficiencies. Insatiable demand and limited supply of acquisition targets drove healthcare deal multiples to the highest levels seen in decades.

As of the writing of this report, macroeconomic factors have impacted the economic recovery that fed deal volume and values in 2021. Particularly, Russia's invasion of Ukraine has disrupted supply chains and increased global uncertainty. Unexpectedly persistent and unacceptably high levels of domestic inflation have made investors more cautious and increased labor costs have pressured provider margins. A hawkish U.S. Federal Reserve has increased investor uncertainty.

Nevertheless, certain tailwinds persist for healthcare M&A.

First, the amount of capital funding allocated to healthcare investing continues to increase. It is estimated there is $1.6 trillion in dry private equity powder (globally) yet to be deployed. In the U.S., institutional investor allocation of funds to the healthcare sector is beginning to mirror the sector's relative impact on GDP. For reference, approximately 15% of funds are allocated to healthcare while healthcare spending reflects 20% of GDP. We expect these numbers to converge.

Second, healthcare M&A internal rates of return have outperformed the broader market over the past 10 years by approximately 6%. Higher relative returns, combined with the industry's recession resilience, will continue to drive new capital into the space.

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Third, strategic players (i.e., the incumbents) who have been dealing with COVID-19 on a clinical level have seen how the pandemic has changed the industry trends in ways that open broad opportunities. Virtual interactions, alternative sites of care, and innovative provider models were buzzwords before the pandemic and are now daily realities.

Taken together, the transition to an endemic COVID-19, and the resolution of short-term macroeconomic factors, will create new opportunities for strategic and private equity investors. In the short-term, additional emphasis should be placed on deal diligence (i.e., labor costs, supply chain, volumes). In the long term, emphasis should be placed on lasting structural opportunities.

Leveraging VMG Health's expertise as the leading provider of healthcare transaction and valuation services, this annual report examines the healthcare M&A landscape in 2021 and the 2022 outlook. We analyze transaction activity, regulatory changes, reimbursement outlook, M&A outlook, and other industry dynamics driving M&A across several prominent healthcare verticals. Namely:

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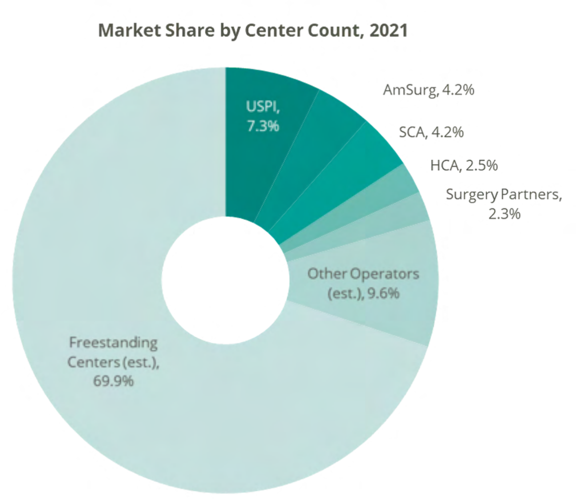
Ambulatory Surgery Centers

Between 2011 and 2021, the total number of Medicare-certified ambulatory surgery centers ("ASCs") in the United States grew at a compound annual growth rate of 1.4%, and increased from 5,217 to 5,906 Medicare-certified ASCs. The ASC industry continues to remain highly fragmented with approximately 70% of freestanding ASCs being independently owned and operated. The remaining 30% of the ASC industry is owned and operated by large players including AmSurg Corp. (merged with Envision Healthcare), United Surgical Partners, Inc. ("USPI", parent company Tenet Healthcare and recently acquired SurgCenter Development's centers), SCA Health ("SCA", owned by Optum/UnitedHealth Group, Inc.), HCA Healthcare, Inc. ("HCA"), Surgery Partners, Inc. ("Surgery Partners", 54% owned by Bain Capital), and other multi-site owners/operators.



Industry Trends

In recent years, certain higher acuity procedures that were traditionally performed in an inpatient or hospital outpatient department ("HOPD") setting have begun to shift to a freestanding ASC setting. This shift established a new standard for the level of acuity that an ASC setting could handle safely and efficiently. Although this shift is expected to continue, the new 2022 Centers for Medicare & Medicaid Services ("CMS") Final Rule provides cause for concern as to whether some of these cases will remain in the ASC setting. The higher acuity specialties, such as orthopedic, spine, and cardiology, have historically been a significant factor for revenue growth in the hospital setting. Therefore, a transition to the ASC setting would undoubtedly result in a business model shift for the not-for-profit and for-profit entities managing the hospitals. For example, Tenet Healthcare ("Tenet"), the parent company of USPI, has consistently noted they are working towards USPI comprising 50% of the company's EBITDA by the end of 2023. For reference, as of 2021, the USPI division accounted for approximately 34% of the company's EBITDA. In support of this goal, Tenet plans to acquire or develop over 150 ASCs by the end of 2025.

In addition to the major operators, private equity ("PE") investors have begun investing more intentionally in this space. PE interest in ASCs is most often tied to their physician practice portfolio companies, notably gastroenterology practices and, increasingly, orthopedic and cardiology practices. Driven by favorable tailwinds, this type of investment in ASCs allows PE investors to capture additional revenue streams related to their physician practice investments. PE interest in an ASC strategy outside of a physician practice portfolio company has also increased recently. In March 2021, Regent Surgical Health received a strategic investment from TowerBrook Capital Partners and Ascension Capital, and in March 2022 Compass Surgical Partners secured a minority investment by Health Velocity Capital.

Health Velocity Capital's investment in Compass Surgical Partners also illustrates the increasing focus on value-based care and bundled payments in the ASC setting. During the latest earnings call, Tenet leader Saumya Sutaria

noted, “The entirety of USPI is an enormous value-based care opportunity because of the lower costs that are incurred in performing surgeries and procedures in a very high-service, outpatient-based, lower cost environment.”

Surgery Partners have also begun aligning a portion of its business with value-based care through its recent partnership with Privia Health located in Montana. J. Eric Evans, CEO and Director of Surgery Partners said, “Whether it's Privia or other value-based care providers where we have an aligned kind of footprint, or can build an aligned footprint, we think we're extremely well positioned to do that as the independent short-stay national operator.”

These growth opportunities provided by the outpatient care setting will likely continue to attract additional suitors and further drive the growth and consolidation of the subindustry.

“We target acquisitions pricing around 7x to 9x adjusted EBITDA plus or minus depending on the specialty.”

J. Eric Evans
CEO & Director, Surgery Partners
Q4 2021 Earnings Call

In 2021, VMG Health observed a tightening in the valuation multiple ranges for ASC transactions. While the median total invested capital (“TIC”) to earnings before interest, taxes, depreciation, and amortization (“EBITDA”) multiples remained flat, the 25th percentile increased and the 75th percentile decreased from 2020 to 2021. The wider range in 2020 is likely attributable to the uncertainty in the industry as a result of the COVID-19 pandemic during that time. Relative to before COVID-19, we have observed an increase in multiples converging to the 7.5x to 8.5x range, consistent with Evans’ comments during Surgery Partners’ Q4 2021 earnings call.

TIC / EBITDA	2017	2018	2019	2020	2021
25th Percentile	6.0x	6.6x	6.5x	6.9x	7.5x
Median	6.8x	7.4x	7.7x	7.8x	7.8x
75th Percentile	7.4x	7.9x	8.4x	9.7x	8.4x
Number of Observations	24	30	30	21	25

Source: VMG Internal Database
Note: Chart above represents VMG observed ASC multiples for single-site control level transactions
Disclaimer: The median multiples and multiple ranges can be used to observe a market trend (increase, decrease, tightening, etc.) and should not be used in isolation to develop a valuation for an individual center, which may bear unique characteristics and circumstances. It should also be noted that the valuation multiples above represent those for individual ASCs and not ASC platform companies.

Transaction Activity

Between 2015 and 2018, the ASC industry went through a period of consolidation culminating in several mega-mergers which are transactions that unite two large corporations valued at billions or more. The result of the mega-mergers is they reshaped the industry.

In 2015, Tenet and USPI merged; while in 2016, Envision Healthcare Holdings and AmSurg Corp. merged. In 2017, SCA was acquired by Optum (a subsidiary of UnitedHealth Group), National Surgical Healthcare was acquired by Surgery Partners, and Bain Capital acquired a controlling equity interest in Surgery Partners. In addition, private equity firm KKR & Co. ("KKR") made two large acquisitions of ASC operators during this period and acquired Nashville-based Covenant Surgical Partners, an operator of ASCs and physician practices across 17 states. In October 2018, KKR finalized its acquisition of Envision and its subsidiary AmSurg. The history of mega-transactions has left only one publicly traded pure-play ASC company remaining, Surgery Partners. The company is publicly traded but controlled by Bain Capital.

In 2020, Tenet finalized a deal for $1.1 billion to acquire 45 ASCs from SurgCenter Development. Tenet further continued its efforts to increase its outpatient footprint, completing a nine ASC deal with Compass Surgical Partners. Additionally, USPI entered into a $1.2 billion deal in Q4 2021 to acquire SurgCenter Development's remaining centers and established a long-term development deal. The transaction included acquiring ownership interest in an additional 92 ASCs, other support services in 21 states, and providing continuity for future de novo development projects.

Outside the 2020 mega-merger between Tenet/USPI and SurgCenter Development, the fragmented ASC industry continues to consolidate. Ascension Capital, an investment arm of Ascension and Towerbrook Capital Partners, invested in Regent Surgical Health in 2021 to act as the development partner to spearhead future growth opportunities.

Additionally, HCA announced in Q4 2021 that it increased the ambulatory care sites in its networks by 14% during 2021. Earlier in the year, HCA CEO, Sam Hazen, stated, "We continue to invest broadly across our networks to improve convenience, access, and value for patients by developing more outpatient facilities. The pipeline for development and acquisition in this category remains strong."

Lastly, during Surgery Partner's Q4 2021 earnings call, CEO and Director J. Eric Evans noted, "Our pace of capital deployment has accelerated with approximately $325 million of acquisitions completed in 2021 at multiples consistent with what we have historically seen of approximately eight times." The amount of Surgery Partner's 2021 acquisitions is particularly notable considering it spent $300 million in total on acquisitions over the three prior years.

Reimbursement

On November 2, 2021, CMS released the calendar year ("CY") 2022 Hospital Outpatient Prospective Payment System ("OPPS") and ASC payment system policy changes and payment rates final rule. Based on the final ruling, CMS increased the ASC conversion factor by 2.0% in CY 2021, a decrease from the CY 2021 final rule which increased ASC payment rates by 2.4%. CMS will continue using the hospital market basket for ASC payment rates through 2023 after the shift in 2019. The 2019 move to the hospital market basket update allows ASCs to better keep up with inflation, a move previously applauded by the Ambulatory Surgery Center Association.

In 2018, CMS removed total joint replacements from the inpatient-only list ("IPOL"). Additionally, private insurance companies have also become more willing to cover total joint procedures in an outpatient setting. In 2019, a revision by CMS resulted in the addition of 12 cardiac catheterization procedures to the list of procedures approved by Medicare to be performed in an ASC setting ("ASC-approved list").

In 2020, total knee arthroplasty was made eligible for Medicare payment in the ASC setting by CMS. Knee mosaicplasty, six coronary intervention procedures, and 12 procedures with new CPT codes were also made eligible for Medicare payment. With the 2021 final rule, CMS announced its plan to phase out the IPOL over a three-year period. Notably, in the CY 2022 final rule, CMS stated that it would reverse course on this policy change that added a significant number of codes to the ASC-approved list and began the process of eliminating the IPOL. As a result, many of the procedures that were removed in 2021 were added back to the IPOL. The change could potentially reduce the speed that cases have been shifting from a hospital outpatient setting to ASCs.

Conclusion & Future Outlook

The ASC marketplace continues to be an active transaction arena as major operators consolidate and look for new opportunities in this space. In addition to the legacy operators, we are beginning to see other types of investors show interest in the space. ASCs are expected to remain attractive targets over the long-term investment horizon due to their ability to generate consistent distributable cash flows and to contribute to lower cost of care in the United States. Although the removal of certain higher acuity procedures may result in a near-term disruption to certain ASCs, a continued increase in growth and consolidation in this subindustry is expected throughout the remainder of 2022 and beyond.

More ASC Thought Leadership

- ASC Reimbursement Considerations for a Transaction
- ASCs in 2021: A Year in Review
- CY 2022 Medicare OPPS and ASC Payment System Final Rule
- Ambulatory Surgery Centers are in the Spotlight in the OIG Advisory Opinion No. 21-02

Diagnostic Imaging Centers

The diagnostic imaging market in the United States is estimated to generate over $100 billion in annual revenue. Imaging services are typically differentiated between hospital-based imaging and non-hospital-based imaging. The hospital-based imaging (which includes inpatient imaging and HOPD imaging services) accounts for an estimated 60% of the total imaging market in terms of net revenue. The diagnostic imaging center market consists of HOPDs, freestanding imaging centers, and physician in-office imaging and is highly fragmented with RadNet, Inc. ("RadNet") as the largest single operator that controls 347 imaging centers as of December 31, 2021.

COVID-19

On March 18, 2020, CMS announced their recommendation that all elective surgeries, non-essential medical, surgical, and dental procedures must be delayed for the duration of the COVID-19 pandemic. Non-urgent imaging procedures were also postponed. For imaging centers, these delayed services included screening mammography, lung cancer screening, computed tomography ("CT"), ultrasound, x-ray, and magnetic resonance imaging ("MRI") throughout 2020.

As vaccinations for COVID-19 became widely available and COVID-19 cases slowed, pent-up demand resulting from deferred care resulted in patient volume returning to normalized levels in 2021. Although the industry experienced recovery during 2021, larger operators fared better than smaller operators during this time. The prolonged period of depressed volumes because of the COVID-19 pandemic and reimbursement pressures helped fuel the M&A activity that heavily ramped up during 2021 as marginal operators were less able to sustain the losses incurred. Between December 31, 2020, and December 31, 2021, RadNet acquired 27 new radiology centers.Moving into 2022, it appears larger operators such as RadNet are considering the current environment as "post-pandemic" and are seeking new opportunities for growth.

"Our centers are extremely busy and we are pursuing expansion opportunities in all of our core markets through a focus on same center performance, de novo centers, health system partnerships, and tuck-in acquisitions."

Howard G. Berger
Chairman, President & CEO, RadNet
Q1 2022 Earnings Call

M&A Trends

Several trends that fostered M&A activity in 2020 and 2021 are expected to continue throughout 2022. These trends include consolidation to access economies of scale, the migration of volume from inpatient to outpatient settings,

private equity interest in the industry, and the backlog of imaging demand following the COVID-19 pandemic. In addition, some recent trends such as technological investments have been driving M&A activity in the imaging landscape.

The migration of imaging volumes from hospital-based settings to outpatient centers is expected to continue to drive M&A activity in 2022. Payors are drawn to the cost savings associated with outpatient imaging facilities, which cost anywhere from 30% to 50% less than hospital-based settings per Sonos Imaging. Physician referral source trends also indicate an increasing preference for outpatient imaging centers which generally offer a more personalized and comfortable patient experience. Further, streamlined processes within the outpatient setting result in less time spent in the center as opposed to a hospital which can be much harder to navigate. The pandemic amplified this trend as patients were more hesitant to enter hospital settings due to the increased risk of COVID-19 exposure. The resulting backlog of imaging demand is expected to continue to drive elevated volume levels into 2022.

Although the imaging landscape in the United States remains highly fragmented, physician-owned imaging centers and independent imaging centers are increasingly having to contend with health systems, larger operators, and private equity-backed groups. With easier access to capital, larger operators can adopt aggressive acquisition strategies and attain economies of scale which was the primary focus of M&A activity throughout 2021. The scale that a large operator can attain offers market dominance and less competition, diversified revenue streams, less exposure to geographic reimbursement changes, streamlined administrative and operational abilities, and greater negotiating leverage with payors.

Larger operators have become increasingly keen on joint venture ("JV") partnerships given the value prospect of management fees. JV partnerships also offer large operators the potential for further service offerings with partners as well as opportunities for population health management. Smaller operators often favor JV partnerships as they provide access to the benefits of scale with minimal oversight. As a result, the industry remains ripe for consolidation activity through the rest of 2022 with scale becoming increasingly important for an imaging business' long-term viability and competitive edge.

"M&A transactions and JVs will continue to be big parts of our strategy going forward."

Mark Stolper
Chief Financial Officer, RadNet
Q1 2022 Earnings Call

More recently, technological investments have driven M&A activity in the industry. Radiology-focused Artificial Intelligence ("AI") and other advanced scanning technologies have been a key component in recent transactions. These efficient technologies can help operators increase throughput and overall scan volume. Further, large operators who choose to invest in technology also gain access to new revenue streams by selling their efficient scanning solutions to smaller operators and, more importantly, accessing international markets with very low capital requirements. Finally, AI and other scanning technologies may offer significant cost reduction opportunities. RadNet has been a first mover in pursuing AI opportunities in cancer screening for large patient populations through two investments in Q1 2022 including Aidence Holdings BV and Quantib BV. Both companies offer RadNet cutting-edge AI scanning technologies for three of the four most prevalent cancers. The potential for AI presents a new avenue for investment and M&A activity in the imaging space as it continues to evolve.

Notable Deals

There have been numerous small to medium-sized operator acquisitions and JV partnerships throughout 2021 and early 2022, including RadNet's acquisition of 10 facilities in New York's metropolitan area in Q1 2021. This was followed by five more acquisitions by RadNet across New York, New Jersey, and California in Q2 2021. The Los Angeles-based operator also closed a JV partnership in Frederick, Maryland as well as an eight-center acquisition and JV with Dignity Health in Phoenix, marking its first move into the Arizona market.

"Our M&A pipeline really is focused on existing markets, [...] we believe that we can continue to buy those transactions in the 4x to 6x range."

Mark Stolper
Chief Financial Officer, RadNet
Q1 2022 Earnings Call

PE activity in the imaging space has been gaining traction over the past year. This has been primarily led by RAYUS Radiology, a national provider of advanced diagnostic and interventional radiology backed by Wellspring Capital Management. RAYUS, formerly known as the Center for Diagnostic Imaging, has been on a consolidation spree as part of its growth strategy, and has acquired several radiology groups across the country. In Q2 2021, RAYUS acquired InHealth Imaging, and added three new locations to its existing footprint in Washington's Puget Sound market for a total of 14 locations. RAYUS also acquired Foundational Radiology Group in Q2 2021, a Pittsburgh-based, full-service radiology provider with more than 100 radiologists delivering on-site and teleradiology services to over 45 health systems, community hospitals, prominent academic medical centers, and outpatient imaging facilities across seven states. Further, the group took a majority interest in The Research Radiology Institute and acquired Sand Lake Imaging in Orlando, Florida. This acquisition added three more centers to its existing footprint in the Central Florida region.

Mark Stolper
Chief Financial Officer, RadNet
Q1 2022 Earnings Call

"When larger transactions come available they seem to be garnering a lot of attention from private equity firms who are looking at those businesses as platform businesses, and they're going for a significantly higher multiple than we've typically paid for tuck-in transactions in our existing markets."

Imaging-related M&A activity is off to a strong start in 2022 as Advanced Imaging Alliance, a trio of private radiology practices spread across three states, announced plans to merge and represent a total of 76 radiologists. The practices involved include X-Ray Consultants and its 11 physicians in Indiana; Naugatuck Valley Radiological Associates and its 11 physicians in Connecticut; and Huron Valley Radiology employing 54 providers in Michigan. Additionally, Tyler Radiology and East Texas Radiology Consultants in Longview, Texas announced plans to merge

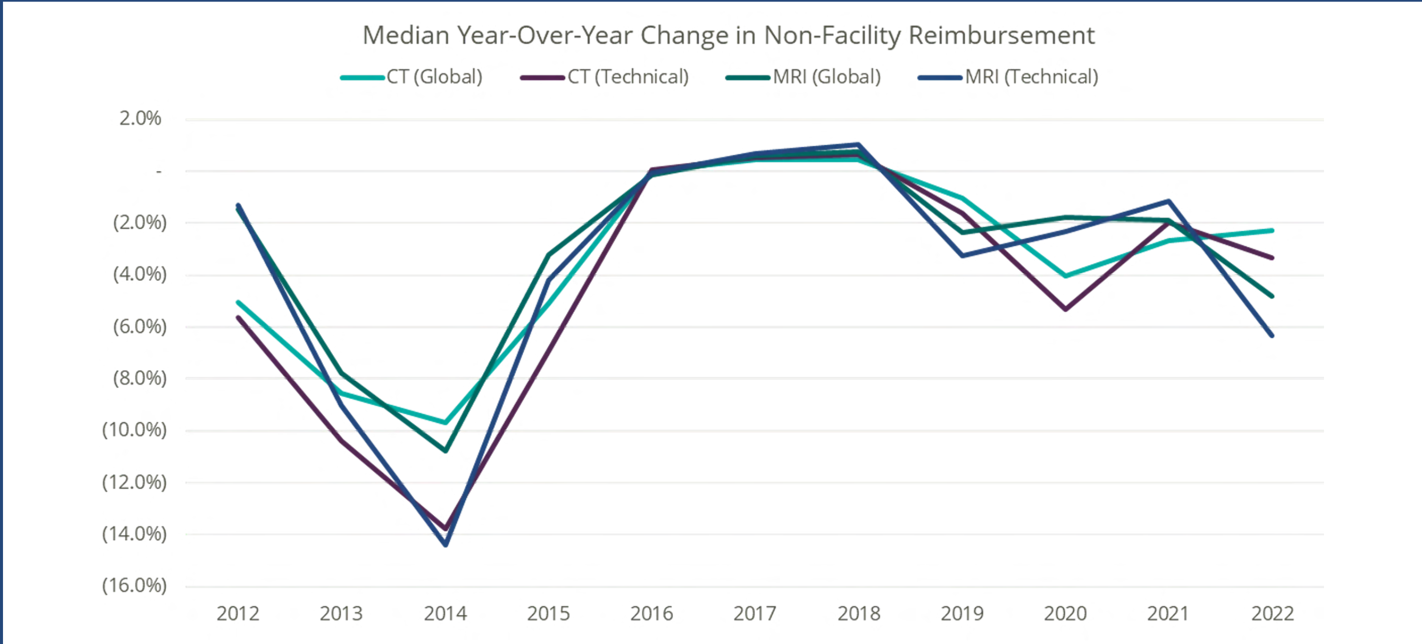
with Fort Worth-based Radiology Associates of North Texas ("RADNTX") and added 28 new physicians for the group. This will expand RADNTX to more than 200 imaging physicians and will make it one of the state's largest groups. Lastly, Strategic Radiology, a growing coalition of independent imaging groups, recently marked its first foray into New Mexico by adding a new member practice that employs 42 physicians. The practice also has a notable ambulatory element that includes a freestanding center and two more outpatient locations that are run through a JV partnership with Presbyterian Health Plan.

Reimbursement

Since the passage of the Deficit Reduction Act of 2005, there have been significant reimbursement cuts for imaging centers. The reimbursement cuts have targeted perceived overutilization and have been structured to incentivize upgrading equipment by providing lower reimbursement to older, technologically outdated scanners. The cumulative result is a dampening of cash flow returns to imaging center investors as both operating expenses and capital expenses increase as a percentage of revenue.

Since 2010, CMS has made several revisions to the methodology utilized to determine relative value units ("RVU") under the Medicare Physician Fee Schedule ("MPFS") which have resulted in reimbursement cuts for imaging procedures. While the changes have impacted all imaging modalities, advanced imaging modalities, such as MRI and CT, have experienced larger reimbursement cuts due to their higher reimbursements and perceived overutilization.

As an example of the impact of these cuts, the chart below shows the median annual MPFS reimbursement change for the global and technical components of MRI and CT codes from 2012 to 2022. From 2012 to 2015, MRI and CT experienced reimbursement cuts as a result of the RVU changes. The largest reimbursement cuts occurred in 2014 because of the increased equipment utilization rate implemented by CMS. From 2016 to 2018, reimbursement for CT and MRI remained relatively flat. However, from 2019 to 2022 reimbursement for CT and MRI procedures has steadily decreased.



**Note: The chart presented above represents the median year-over-year change for selected MRI and CT CPT codes. Actual reimbursement changes for any particular provider will depend on scan mix. Further, the reimbursement changes reflected above do not include reimbursement cuts resulting from MPPR cuts, CPT code bundling, or sequestration.*

Medicare pays for non-hospital-based imaging services under the MPFS and hospital-based imaging services under the OPPS. On November 2, 2021, CMS released the CY 2022 MPFS payment and policy changes final rule. As a result of required budget neutrality adjustments and the expiration of the 3.8% CY 2021 payment increase provided by the Consolidated Appropriations Act, 2021 ("CAA"), the MPFS conversion factor decreased for a second consecutive year.

Conclusion & Future Outlook

The M&A landscape is poised for continued activity throughout 2022. As the industry emerges from the COVID-19 pandemic and recent reimbursement pressures, we expect continued consolidation of the smaller operators. Additionally, we expect increased M&A activity through 2022 due to significant volume recovery since the pandemic, rising private equity interest within the industry, and an increased focus on AI technology.

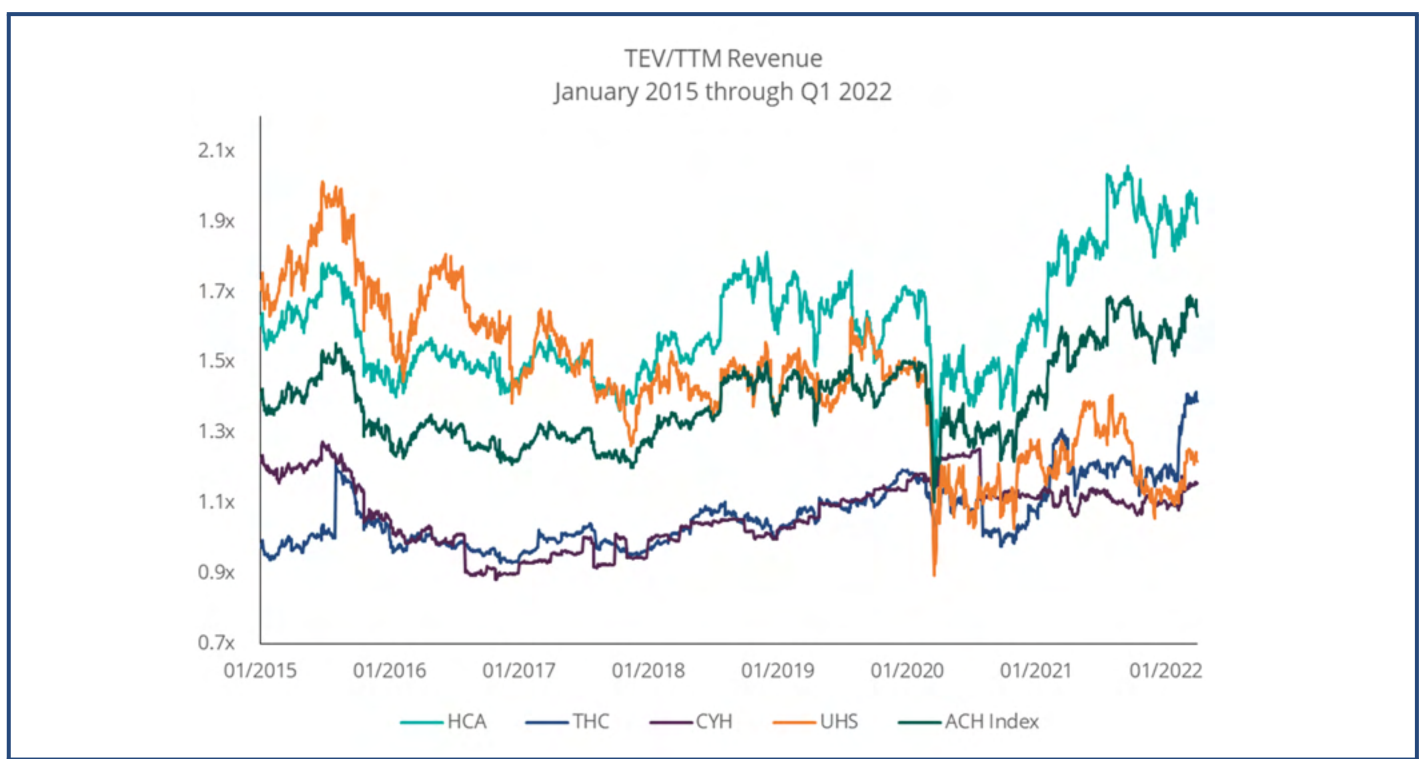
More Imaging Thought Leadership

- 2021 Diagnostic Imaging Rate Changes: Impact & Outlook

Acute Care Hospitals

As of May 2022, there are over 5,400 acute care hospitals (“ACH”) in the United States, including critical access hospitals. In 2021, spending on hospital services accounted for 32% of total national health expenditures which was the largest category. Total hospital spending has increased 5.6% compounded annually from $1.078 trillion in 2017 to $1.342 trillion in 2021. The growth in hospital spending continues to account for a significant portion of the growth in total national healthcare expenditures in recent years.

The chart below presents TEV/TTM revenue multiples for the major public ACH operators as well as the VMG Health ACH Index since January 1, 2015. The VMG Health ACH Index consists of HCA, Community Health Systems, Inc. (“CHS”), Tenet ("THC"), and Universal Health Services, Inc. (“UHS”). The VMG Health ACH Index ended March 2022 with a TEV/TTM Revenue multiple of 1.63x which was greater than the TEV/TTM Revenue multiple of 1.45x at the end of 2020. Please note that HCA’s TEV/TTM Revenue multiple is 1.89x, and is higher than CYH at 1.11x, THC at 1.33x, and UHS at 1.21x. HCA has the largest market capitalization of the four companies.



COVID-19

On March 27, 2020, Congress passed the CARES Act providing approximately $100 billion for distribution to ACHs in the United States. The American Hospital Association applauded the bill, stating, “this support will help those hospitals from rural and urban communities that are in dire financial need due to this devastating pandemic.”

COVID-19 significantly disrupted hospital operations beginning in March 2020 and a continued ripple effect created new hurdles throughout 2021 and into 2022. Seasonal waves of COVID-19 cases have proven to be unpredictable in terms of timing, length and severity of surge, resources required, political response, labor shortages, and more. In addition, ACHs experienced staffing shortages due to concerns about COVID-19 exposure and vaccine mandates. To staff the facility, ACHs turned to travel nurses and locum opportunities, which often resulted in favorable rates for the locum employee.

ACHs are left understaffed as burnout and attractive pay raises in other fields lead to high levels of staff turnover. Intensive care units ("ICUs") and nursing staff have reported turnover rates as high as 30% in post-pandemic months. ACHs, especially in rural settings, recruited travel nurses at salaries up to five times higher than in-house nurses to fill voids left by chronic understaffing. The Healthcare Financial Management Association reported that compared to pre-pandemic levels, overtime hours have been reported to be higher by as much as 52% and clinical labor costs on a per patient basis have increased by approximately 8.0%. This strained labor environment has resulted in ACHs facing both financial and operational risks without a clear end in sight.

"I think we found labor issues to be kind of stickier and more difficult to navigate in the back half of the quarter than we were expecting."

Steve G. Filton
Executive VP, CFO & Secretary, Universal Health Services
Q1 2022 Earnings Call

The Bureau of Labor Statistics' ("BLS") Occupational and Employment Statistics ("OES") further outline nurse staffing shortages in U.S. hospitals. Across the U.S., 11 states employed fewer nurses in 2021 as compared to 2015 and 26 states have fewer nurses in 2021 as compared to 2020. The mean annual salary for nurses increased 3.9% in 2021, which is the largest increase since at least 2015. In addition, four states saw increases in mean annual salary larger than 5.0% in 2021: D.C. (10%), Georgia (6.3%), New York (5.1%), and Washington (5.1%). This trend is expected to continue during 2022.

On March 18, 2020, CMS released a recommendation that all elective surgeries, non-essential medical, surgical, and dental procedures should be delayed during the outbreak. In April 2020, CMS released a recommendation that providers should work with state or regional public health officials to determine whether their area passed certain criteria to justify resuming elective procedures. Despite this, many hospitals in states where elective procedures were allowed to resume opted to suspend elective procedures to free up space, staff, and resources at a time when a surge of COVID-19 was expected. For example, over 100 hospitals nationwide suspended elective procedures in June 2021 to prepare for a potential spike in cases to ensure efficient staffing and to conserve protective gear for COVID-19 patients. As recently as August 2021, state governments were asking ACHs to delay elective procedures to ease capacity concerns in inpatient settings across the country. Furthermore, the market downturn of 2022 coupled with record inflation has caused disposable income to decrease on a widespread level and further delayed some revenues from elective procedures.

The most significant volume declines for hospitals were emergency room ("ER") visits which decreased over 12% in 2021 as compared to 2019. Additionally, the influx of COVID-19 patients has shifted the payor mix of many hospitals away from commercial payors toward Medicare and Medicaid. The decline in the volume of elective and ER business has resulted in a significant strain on the cash flows of hospitals and health systems. As of December 2021, median EBITDA margins were 22% below 2019 pre-pandemic levels.

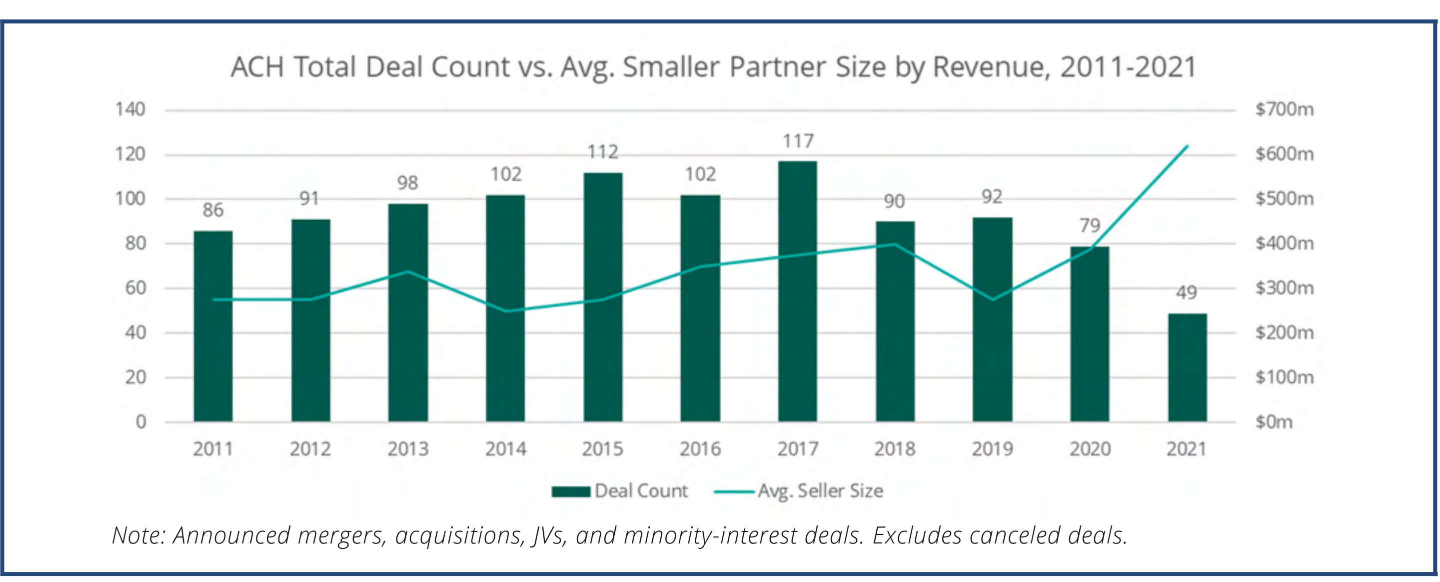
> "Generally, in my history, anytime you get through a disruption effort, and if COVID was a disruption, over the next couple of years, some of those opportunities [i.e., larger new market acquisitions] present themselves."

William B. Rutherford
Executive VP & CFO, HCA
3rd Annual Wolfe Research Virtual Healthcare Conference 2021

The COVID-19 pandemic moved many experienced leaders in the ACH industry to retire earlier than anticipated. This result is commonly referred to as the "Great Retirement." Becker's Hospital Review reported that many of the leaders leaving "led their health systems through numerous milestones and headwinds," and concluded that there will not be enough experienced succession candidates to replace them. This trend could have a profound impact on consolidation activity in 2022 as ACHs may encounter difficulty with less-experienced management teams.

Industry Trends

ACH M&A activity slowed in 2021 as compared to pre-pandemic numbers, likely due to deteriorating economic conditions and continued industry headwinds. The number of announced ACH transactions decreased from 92 in 2019 to 79 in 2020 to 49 in 2021. The announced transactions during 2021 are the lowest number of M&A activities reported in the last 10 years. Conversely, the average target size, by revenue, increased to its highest level in the last decade to $619 million in 2021. The 2021 average transaction size represents an approximate 8.5% compound annual growth rate since 2011.



Note: Announced mergers, acquisitions, JVs, and minority-interest deals. Excludes canceled deals.

There were eight mega-mergers in the AHC marketplace during 2021. The latest mega-merger, announced on May 11, 2022, is the merger of Advocate Aurora Health and Atrium Health. This merger will create one of the nation's largest nonprofit health systems with $27.1 billion in combined revenues and 67 hospitals across six states. The partnership may be able to bypass strict regulatory scrutiny as the two systems operate in different regional markets (South and Midwest), while at the same time reaping the reward of a more defensive position against labor and inflationary hurdles.

Anticipating a future where this sizeable system is no longer needed to combat rising costs, the system has structured the deal as a Joint Operating Company ("JOC"), thereby making it easier to unwind. The group is expected to operate under the brand "Advocate Health." As this mega-merger was announced in 2022, it is excluded from the 2021 figures discussed and presented above.

In addition, Intermountain Healthcare ("IHC"), headquartered in Salt Lake City, and Colorado-based SCL Health completed a merger after receiving official approval in April 2022. This merger also created one of the largest nonprofit health systems in the country. After IHC's merger discussions with Sanford were terminated it revealed that it was ready for and seeking a strategic partner.

The chart below represents reported transaction multiples. We note many of these transactions include financial considerations beyond the purchase price. Some of these include future capital commitments for improvements to facilities or hospital programs, required maintenance of specified hospital services for a set time period, or the creation of new programs to provide charitable services such as care to indigent patients, among other non-cash considerations. Therefore, the multiples below should not be used in isolation to develop a valuation or pricing for an individual hospital which may have a different transaction structure and bear unique characteristics and circumstances.

Close Date	Target	Acquirer	Price	Reported TEV / Rev.	EBITDA Margin
Mar-22	West Suburban Medical Center / Weiss Memorial Hospital	Resilience Healthcare	$92,000,000	**0.3x**	**(5.0%)**
Aug-21	Three South Carolina Hospitals (LifePoint)	Medical University of South Carolina	$75,000,000	**0.2x**	**(2.2%)**
Jun-21	Five Florida Hospitals (Tenet)	Steward Health Care	$1,100,000,000	**1.2x**	**5.7%**
May-21	Redmond Regional Medical Center (HCA)	AdventHealth	$637,000,000	**2.5x**	**17.7%**
May-21	Four Georgia Hospitals (HCA)	Piedmont Healthcare	$950,000,000	**1.5x**	**17.2%**
Mar-21	NorthCrest Health	HCA	$45,000,000	**0.7x**	**8.4%**
Jan-21	Meadows Health Alliance, Inc.	HCA	$72,500,000	**0.5x**	**6.5%**

Notable Deals

On February 1, 2021, North Carolina-based Novant Health ("Novant") completed its acquisition of New Hanover Regional Medical Center. Novant partnered with UNC Health and the UNC School of Medicine for the acquisition. As part of the transaction, Novant will invest $5.3 billion into New Hanover which includes over $1.5 billion in upfront cash and $3.1 billion in capital commitments. The cash purchase price results in an implied TEV/Revenue multiple of 1.35x. Additionally, Novant and UNC plan to expand a branch of the UNC School of Medicine, establish a new UNC Health Sciences campus, boost faculty development, and expand its pipeline for students who want to work in rural North Carolina. The deal received final approval from the North Carolina Attorney General in January 2021. Novant competed with Atrium Health and Duke Health in the bid to acquire New Hanover before winning the bid in July 2020. The transaction serves as an example of an independent medical center seeking to strengthen access to intellectual capital resources through alignment with a larger system with academic medical centers and teaching hospitals.

In February 2022, Yale New Haven Health System ("YNHHS") and Prospect Medical Holdings, Inc. ("Prospect") announced the signing of an agreement for YNHHS to acquire two Connecticut health systems from Prospect. The

agreement is set to include the related businesses, real estate assets, physician clinic operations, and outpatient services. Both groups are targeting for this deal to close before year-end of 2022. YNHHS would pick up nearly 2,900 employees across the two health systems, Waterbury HEALTH, and Eastern Connecticut Health Network ("ECHN"). Through this merger, Waterbury HEALTH and ECHN would each become nonprofit organizations.

Divestitures

Prospect, based in Los Angeles, has agreed to multiple deals to sell its seven hospitals in Connecticut and Pennsylvania. On February 11, 2021, Prospect announced that it was selling Crozer Health, a four-hospital system based in Springfield, Pennsylvania to Delaware-based ChristianaCare. In the deal, ChristianaCare would acquire Crozer Health's hospitals, medical groups, ASCs, and clinics.

HCA sold a 230-bed Georgia hospital to AdventHealth with a $635 million price tag, continuing the trend for HCA selling hospitals in the Georgia marketplace. For AdventHealth, the deal will come with related business entities including physician clinic operations, outpatient services, and more than 1,500 employees. At the time of the sale, the deal will remove HCA's footprint out of northwest Georgia. This 2021 deal follows HCA's sale of four Georgia hospitals to Piedmont Healthcare for $950 million.

CHS divested five hospitals in 2021, which was a decrease from 13 in 2020 and 12 in 2019. This follows the same trends as other public companies such as Tenet divesting 11 ACHs in 2020 and five Miami-based hospitals in 2021. The five divested CHS hospitals are Lea Regional Medical Center (84 beds; sold to Covenant Health System; Hobbs, NM), Tennova Healthcare – Tullahoma (135 beds; sold to Vanderbilt University Medical Center; Tullahoma, TN), Tennova Healthcare – Shelbyville (60 beds; sold to Vanderbilt University Medical Center; Shelbyville, TN), Northwest Mississippi Medical Center (181 beds; sold to Delta Health System; Clarksdale, MS), and AllianceHealth Midwest (255 beds; sold to SSM Health Care of Oklahoma, Inc; Midwest City, OK).

Delayed/Cancelled Mergers

In September 2021, HCA and Steward Health Care ("Steward") announced the signing of an agreement for HCA to acquire the operations of five Utah-based hospitals from Steward. The exact financial terms of this merger have not been disclosed. While this was expected to be the next big mega-merger, the transaction faced scrutiny from the Federal Trade Commission ("FTC") due to concerns of an increase in patient fees and a decline in patient care. The FTC sued to block this merger on June 2, 2022, and the deal was called off. Future notable deals may be subject to the same FTC review.

CommonSpirit Health and Essentia Health called off their deal for Essentia Health to acquire 14 CommonSpirit facilities in North Dakota and Minnesota. This deal was canceled just four months after the announcement was made. Of the 14 hospitals cited in the deal, one was a tertiary hospital, and the other 13 were critical access hospitals. There was not a clear reason why this deal was canceled. Essentia Health operates 14 hospitals, 71 clinics, six long-term care facilities, and other operations while reporting about $2.2 billion in total revenue. CommonSpirit is the largest Catholic health system in the country operating 140 hospitals. The health system had combined revenues of almost $29.6 billion for the fiscal year ("FY") ending June 2020, although it reported a $550 million operating loss.

Virginia-based Sentara Healthcare and North Carolina-based Cone Health called off a planned merger after dozens of public comments came in raising concerns about hospital consolidation and its impact on prices. This deal would

have created a 17-hospital system with over $11 billion in assets. This merger received over 50 comments submitted to the attorney general's office pleading for the deal to not be approved. Opponents of the deal argued that a Virginia-based health system could not serve the North Carolina region appropriately, Cone Health was already too large of an entity, and this combination of two large players could be detrimental to North Carolina healthcare.

As of May 2022, Dartmouth Health and GraniteOne Health are canceling their proposed merger after the attorney general's office ruled the deal would violate the New Hampshire constitution. Attorney General John Formella said the merger would combine two competitors into a single health system controlled by Dartmouth Health. He said this would end competition between the two systems and raise healthcare costs in the relative markets.

Rural Hospitals

The Center for Healthcare Quality and Payment Reform ("CHQPR") lists 636 rural hospitals as at risk of closure, which represents 30% of the 2,125 rural hospitals in the U.S. While 19 rural hospitals closed in 2020 related to COVID-19, only two hospitals closed in 2021. This decrease in rural hospital closures is largely related to special one-time governmental assistance related to the COVID-19 pandemic. As this aid is not expected to continue in the future, these rural hospitals face an increased risk of closure looking into 2022. The effects of the COVID-19 pandemic, uninhibited by governmental assistance, are expected to catch up to these facilities.

One of the most cited reasons for difficulties faced by rural hospitals is the high amount of uncompensated and under-compensated care due to the higher rates of uninsured, Medicaid, and Medicare patients in rural communities compared to urban areas. Other reasons include the inpatient-to-outpatient care transition leading to excess capacity, a lack of sufficient capital to invest in updated technology like electronic health records needed for quality reporting, insufficient patient populations due to smaller rural communities, and physician shortages due to the remote location of subject hospitals.

As a result of the COVID-19 pandemic, a new group of hospitals sharing the same characteristic have become at risk: hospitals with a high dependence on non-patient service revenues such as funding from local taxes or state subsidies. These hospitals have had positive earnings, but only because this alternative source of funds has allowed them to offset losses on patient services. Hospitals falling in this category are now considered high-risk due to the lack of clarity on whether they will continue to receive revenue from non-patient sources.

Reimbursement

On August 2, 2021, CMS released the FY 2022 Inpatient Prospective Payment System ("IPPS") policy changes and payment rates final rule. Based on the final rule, IPPS payment rates will increase by 2.5% in 2022, a decrease from the FY 2021 final rule which increased the IPPS payment rates by 2.9%. Additionally, CMS estimates that it will distribute roughly $7.2 billion in FY 2022 for uncompensated care payments which is less than FY 2021's $8.3 billion amount. In the future, CMS is looking to change the IPPS operating market basket to be based on a 2018 base year to reflect a less volatile capital market basket. Looking to 2023 payment rates, according to an April 2022 filing by the CMS, general ACHs are projected to get a 3.2% payment rate payment increase.

Similarly, on November 2, 2021, CMS finalized the FY 2022 OPPS changes. This update is based on a market basket increase of 2.7% then reduced by a 0.7% productivity adjustment. This increase is only for ACHs that meet certain quality reporting requirements. Like the IPPS policy changes, CMS will use the 2019 data to estimate expected costs for 2022 as more recent years are affected by the COVID-19 pandemic.

The 2022 final rule also includes new measures aimed at improving price transparency for consumers. In recent years, CMS has continued to push for reducing healthcare costs by making patients more informed about what they might pay for hospital items and services. The 2019 final rule required hospitals to make public a comprehensive, machine-readable list of standard charges for all items and services. With the 2022 final rule released in August 2021, CMS announced new measures, excluded previous measures, and finalized changes to current electronic health record ("EHR") certification with the goal of incentivizing hospitals to use standard and secure technology. While price transparency measures have been in place since January 1, 2021, compliance has been hard to come by. Per a February 2022 report from PatientRightsAdvocate.org, only 14% of hospitals were compliant with the ruling. However, this is an improvement from the July 2021 report which estimated only 5.6% of hospitals were compliant.

To increase hospital price transparency compliance, CMS suggested the implementation of several modifications. First, the daily civil monetary penalty increased starting January 1, 2022, and resulted in an annual penalty range of $109,500 to $2,007,500 per hospital based on bed count. Second, CMS included state forensic hospitals in price transparency requirements as well. Lastly, CMS required machine-readable files to be accessible to automated searches along with direct downloads.

The "Protecting Medicare and American Farmers from Sequester Cuts Act," which was passed on December 10, 2021, brought back Medicare sequester cuts that were in place before the CARES Act suspended the cuts as a response to COVID-19. Sequestration is the cancellation of specific federal government spending which is capped at a 2% reduction for Medicare. Previous legislation pushed back the suspension of cuts, but Medicare sequestration will be back in effect in April 2022. The cut from April 1, 2022, through June 30, 2022, will be 1% and then return to 2% thereafter.

Conclusion & Future Outlook

By navigating the economic uncertainty, regulatory scrutiny, and increased labor and inflationary pressures initiated by COVID-19, ACH M&A in 2021 continued, albeit with unique characteristics and at a slower pace as compared to prior years. FY 2021 was the year of the mega-merger, seeing eight transactions where the target had at least $1.0 billion in revenue. Public ACH operators continued to divest non-core assets while shoring up resources to better serve other ACHs. Increasing labor costs and the current U.S inflationary environment catalyzed transaction activity, while antitrust regulation pushed health systems to affiliate with new regions, expanding the breadth and position of existing systems. ACHs finding themselves unable to compete or adapt may be forced to consolidate with larger systems or face the possibility of closure. As the cost of capital increases to temper inflation, and as hospitals navigate continued cost pressure during 2022, the market will likely experience continued M&A but there may be pressure on valuations due to either underlying financial performance or the willingness of buyers to pay a premium multiple.

More Hospital Thought Leadership

- Public Healthcare Operators: Valuation Trends Summary
- Five Key Takeaways From the Public Healthcare Operators in 2021
- Hospital Subsidy Support for Exclusive Anesthesia Group Practices Expected to Rise
- Post-COVID Healthcare Operator Guidance: Comparing Recent Guidance Figures from the Public Healthcare Operators to Levels Estimated Prior to the COVID-19 Pandemic
- Are You Under (or Over) Insured? Analyzing Replacement Cost for Hospital Systems, Investors & Other Healthcare Providers

Physician Medical Groups

The number of physicians in the United States has increased 1.2% compounded annually from approximately 814,000 in 2000 to 1.1 million as of January 2022. Approximately 87% of active physicians primarily focus on providing patient care. The remaining 13% of physicians focus on teaching, research, and other professional activities. There are over 150 specialties and subspecialties recognized by the Accreditation Council for Graduate Medical Education. The largest specialties in terms of active physicians are internal medicine and family medicine/general practice. These specialties account for approximately 19% and 14% of total active physicians, respectively.

COVID-19 and Other Trends

Physician medical groups ("PMGs") have been disproportionately impacted by the COVID-19 pandemic. Most services furnished in a physician practice setting are classified under CMS' recommended guidelines. As a result, physician practices were forced to temporarily shutter while the healthcare system focused its efforts and resources on high-acute inpatient settings.

While data is still preliminary, spending for physician and clinical services is expected to have grown from $809.5 billion in 2020 to $851 billion in 2021 (a 5.1% growth rate). Due to the COVID-19 funding provided in 2020, the annual growth rate of 5.1% in 2021 is slightly less than the annual growth rate of 5.4% in 2020. However, growth in physician and clinical services spending is expected to increase by 6.2% in 2022 and 5.5% annually from 2025 to 2030.

Historically, the annual volume of PMG transactions has been impacted by large regulatory changes such as the passage of the Affordable Care Act in 2010 and the passage of the Medicare Access and CHIP Reauthorization Act ("MACRA") in 2015. Physicians increasingly opt to align into larger groups, adopt the accountable care organization ("ACO") model, or align with health systems rather than face the burden, expense, and uncertainty of increased regulatory and data reporting requirements alone.

Recently, consolidation has been driven by three primary factors. First, rising labor costs and rising supply costs have affected profit margins for PMGs. Increased unit costs have been a catalyst for buyers seeking to take advantage of economies of scale. Second, independent practices are struggling to keep pace with the capital requirements of the industry's transition to value-based payments. Third, increased competition in physician recruiting from health systems, PE firms, and health insurers has exacerbated a multi-year trend of shortages in the physician labor market.

"We continue to seek to expand our operations by acquiring established physician practices."

MEDNAX
2021 10K

PE firms and their management services organizations ("MSOs") offer the capital and business expertise needed for the scale and operational efficiencies required to combat these pressures. For PE firms, their ability to "roll up" these acquisitions into an efficient, large, and scalable platform is an attractive investment.

Platform practices are typically able to negotiate an acquisition price that is higher than smaller bolt-on practices which are subsequently acquired. A perceived arbitrage opportunity exists if the PE firm can effectively buy a practice at a lower bolt-on multiple and sell the entire business at a higher platform multiple (often sold to another PE firm).

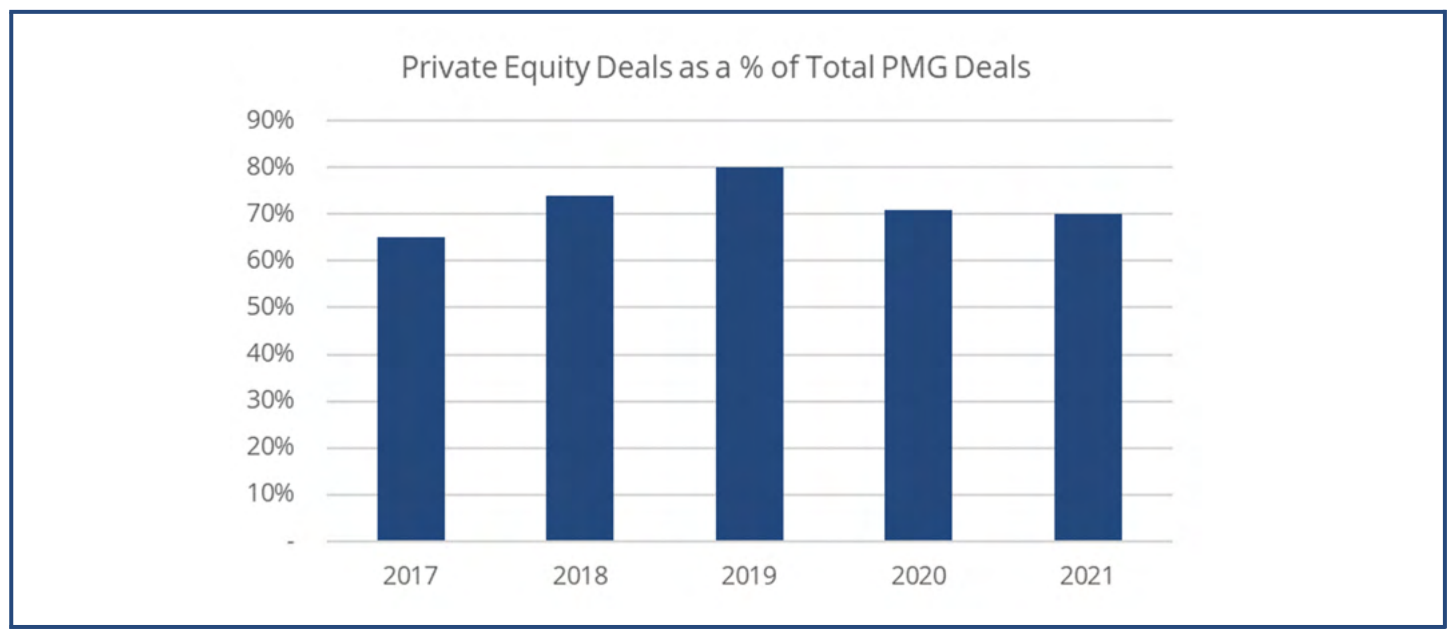
PE firms typically target the ancillary revenue streams of practices that may have historically been performed in a local hospital or other outpatient settings. These ancillary services are consolidated to increase the revenue and earnings growth of the practices. Specialties with high prospects of generating additional incomes from ancillary services and low capital intensity tend to be the targets of PE acquisitions.

There were approximately 461 deals announced in the PMG sector in 2021. This represented an increase of 145% from the 2020 volume. In December 2021 alone, there were approximately 78 deals for PMGs. Approximately 70% of physician transactions in 2021 were attributable to a PE firm or their portfolio companies.

While PMGs cover a wide gamut of specialties, certain specialties showed greater activity than others. Ophthalmology and dental practices represented the most active specialties in terms of transaction volume in 2021. The trend favoring ophthalmology and dental specialties started prior to 2021, and consolidation is expected to continue. Geographically, Texas and California remain large markets ripe for expansion due to aging and burgeoning populations, particularly in Texas.

Source: LeinPro HC, February 2022

Given the fragmentation in the PMG sector, it is expected that interest in other specialties beyond dental and ophthalmology will see increased deal activity. Of interest are those specialties with greater allocation to commercial payors due to higher reimbursement. To emphasize the role of PE in the PMG space, the following table presents the PE involvement in PMG deals since 2017.



Notable Deals

Throughout 2021, MEDNAX acquired nine physician practices. This included one pediatric orthopedic practice, one multi-location pediatric primary and urgent care practice, one pediatric cardiology practice, two pediatric neurology practices, one maternal-fetal medicine practice, one obstetrics and gynecology practice, one pediatric intensivist practice, and one neonatology practice. The total consideration paid for these nine practices was $34.9 million.

In February 2021, WELL Health Technologies Group ("WELL Health") signed an agreement with publicly traded CRH Medical Corporation ("CRH") to acquire all the issued and outstanding shares of CRH. CRH provides physicians with services and products for the treatment of gastroenterology ("GI") diseases and services 69 ambulatory surgery centers in 13 states. CRH has made 31 acquisitions of GI anesthesia practices since 2014, including seven acquisitions in 2020. CRH is emerging as a leading provider for anesthesia services in the GI space. WELL Health is a digital health company that also owns and operates primary care clinics in the U.S. and Canada. The transaction closed on April 22, 2021. Ultimately, WELL Health acquired all common shares of CRH at $4 per share at a transaction value of approximately $372.9 million.

In March 2021, Optum signed an acquisition agreement to acquire Atrius Health for $236 million. Atrius Health is a not-for-profit organization that employs 645 physicians and primary care providers. Atrius Health also has approximately 421 additional clinicians. Recently, the acquisition came under scrutiny by Massachusetts' attorney general who ultimately gave the go-ahead in 2022 as patient services expand in the community and are expected to improve overall patient health in the geographic area. Further, it was announced in April 2022 that Optum acquired the Kelsey-Seybold Clinic, a large multispecialty group practice in Texas. The Kelsey-Seybold Clinic employs more than 500 physicians and operates a variety of facilities such as multispecialty care centers, a cancer center, a woman's health center, two ASCs, and a specialized sleep center. This deal, upon close, will represent a large investment in value-based care by adding a risk-bearing organization to Optum's network. Optum's buying streak continued with its acquisition of Healthcare Associates of Texas, a deal that was announced in June 2022. Optum would acquire Healthcare Associates of Texas from Webster Equity Partners, a transaction that would earn Healthcare Associates of Texas a $300 million enterprise. According to its website in June 2022, Healthcare Associates of Texas had approximately 80 providers.

In May 2021, Partners Group purchased a majority stake in Axia Women's Health ("Axia") from Audax Private Equity for $800 million. Axia has more than 400 providers and serves 475,000 patients annually. Axia is a provider of non-clinical services in the women's healthcare market. Axia is comprised of 80 care centers at 150 locations. A key distinction of Axia is its emphasis on providing services for the full continuum of care for women and it has expanded its geographical presence since it was purchased in 2017 by Audax Private Equity.

Additionally, in May 2021 Gastro Health was sold to private equity company OMERS. Gastro Health was previously owned by Audax Private Equity. The enterprise value is estimated at around $950 million. OMERS Private Equity represents the private equity arm of OMERS, a Canadian pension plan.

Further, in 2021 Cityblock Health, an entity that provided care to approximately 70,000 members as of September 2021, raised capital of approximately $400 million in that same month. The $400 million raised in this late-stage funding pushed Cityblock Health's valuation to $5.7 billion. Cityblock Health provides care for Medicaid and lower-income Medicare beneficiaries. It launched in 2017 and it plans to serve 10 million members by 2030.

In October 2021, Walgreens Boots Alliance announced that it will make an additional investment of $5.2 billion into VillageMD, a national provider of value-based primary care services. Through this investment, at least 600 VillageMD clinics will spring up at Walgreens primary care practices. This estimate of 600 clinics will increase to approximately 1,000 clinics by 2027, with over half located in lower-income communities. As a result of this investment, Walgreens' ownership interest in VillageMD will increase from 30% to 63%. VillageMD plans to have an initial public offering ("IPO") in 2022. As of October 2021, VillageMD operated in about 230 practices.

In 2021, Privia Health Group, Inc. ("Privia") began trading on the Nasdaq Global Select Market. During the same year, it launched a West Texas Health program, entered the California market, launched Privia Care Partners to advance value-based care, and received a Healthcare Financial Management Association award. Privia collaborates with physician medical groups, health systems, and health plans to improve operations at physician practices. It assists practices with the introduction of operational efficiencies and cost containment initiatives. As of its Q4 2021 earnings call, Privia's national footprint included over 3,300 providers caring for over three million patients at 870 locations across eight states and DC.

Reimbursement

On April 14, 2015, the Senate passed MACRA which permanently removed the Sustainable Growth Rate ("SGR") formula from the determination of the conversion factor under the MPFS. Under MACRA, the SGR formula was replaced with fixed 0.5% annual increases through 2019 (note the annual increase was reduced to 0.25% by the Balanced Budget Act of 2019). After 2019, physician payments under the MPFS have remained and will remain flat through 2025. During this period, individual physicians can achieve payment increases through participation in the Merit-Based Incentive Payment System. This system will be developed by the Secretary of Health and Human Services, or participation in an alternative payment model such as an ACO.

On November 2, 2021, CMS released the CY 2022 MPFS final rule payment and policy changes final rule. The CY 2022 physician fee schedule ("PFS") has a conversion factor of $33.59 which is a decrease of $1.30 from the CY 2021 PFS factor of $34.89.

Conclusion & Future Outlook

As a result of the economic impact of the pandemic, PMGs continue to face headwinds associated with rising costs, declining margins, provider recruitment challenges, and uncertainty regarding future reimbursement. Furthermore, physician providers face personal decisions that may affect their desire to sell their business including impending retirement, a desire to reduce the administrative burden to focus on patient care, access to capital, and lucrative exit opportunities. These rationales provide opportunities for PMGs to align with larger groups, sell to private equity firms, or integrate with health systems and insurers. We expect consolidation to continue and deal activity within the sector to remain strong as a result.

More Physician Practices Thought Leadership

- How to Assess Medical Group Performance
- Compensating Physicians for Graduate Medical Education Services
- Important Guidelines for Selecting Quality Metrics In Physician Arrangements
- Compensating Physicians for APC Supervision
- Survey Says: The Time to Evaluate Your Market-Based Physician Compensation Plan Designs Is Now
- Three Questions to Consider Before Distributing Value-Based Payments to Physicians

Post-Acute Care

Post-acute care facilities include inpatient rehabilitation facilities ("IRF"), long-term acute care hospitals ("LTACH"), skilled nursing facilities ("SNF"), home health agencies ("HHA"), and hospice agencies ("HSPA"). Of these facilities, IRFs, LTACHs, and SNFs provide post-acute services in an inpatient setting, and HHAs and HSPAs provide post-acute services in an outpatient setting.

Inpatient Rehabilitation Facilities ("IRF")

The number of Medicare-certified IRFs decreased from 1,221 in 2004 to 1,161 in 2013, or 0.6% compounded annually. This decline is attributable to the reimplementation of the 75% rule ("75% Rule") in 2004. The 75% Rule required that 75% of patients admitted to an IRF have a primary diagnosis that falls within 13 distinct high acuity diagnostic categories. Even though the Medicare, Medicaid, and SCHIP Extension Act of 2007 ("MMSEA") lowered the 75% threshold to 60%, the effects of the rule still resulted in a large decrease in IRF volume. The decrease was driven by limiting the number of hip and knee replacement patients that could be treated at an IRF. It should be noted the number of Medicare-certified IRFs decreased 0.4% compounded annually from 1,182 in 2015 to 1,159 in 2020.

IRFs can be licensed as a freestanding facility or as a hospital-based IRF, which is a specialty unit located within an ACH. As of 2020, there were 310 Medicare-certified freestanding IRFs and 849 Medicare-certified hospital-based IRFs. Of the Medicare-certified facilities, total freestanding IRFs increased 3.4% compounded annually since 2015, while total hospital-based IRFs decreased 1.6% compounded annually over the same period.

On July 29, 2021, CMS released the FY 2022 final payment rule for the IRF PPS which resulted in a standard payment conversion factor increase of approximately 2.3%. This was an increase from the FY 2021 final payment rule which had previously resulted in a standard payment conversion factor increase of approximately 2.2%.

Long-Term Acute Care Hospitals ("LTACH")

The passage of the MMSEA imposed a moratorium on new LTACHs from 2007 to 2012, unless specific exemptions were met. The moratorium on LTACHs was reinstated by the SGR Reform Act for a three-year period from April 2014 to September 2017. As a result of the moratoriums, the number of LTACH facilities decreased 1.7% compounded annually from 426 in 2008 to 348 in 2020. Over the same period, Medicare spending on LTACH services slowed, and decreased 2.5% compounded annually from approximately $4.6 billion in 2008 to approximately $3.4 billion in 2020. On September 30, 2017, the moratorium on LTACHs expired.

On August 2, 2021, CMS released the FY 2022 final payment rule for the LTACH PPS which resulted in a standard federal rate increase of approximately 1.9%. This was a decrease from the FY 2021 final payment rule which had previously resulted in a standard federal rate increase of approximately 2.3%.

Home Health Agencies ("HHA")

In response to rapid increases in utilization and Medicare spending for home health services in the early 1990s, CMS implemented new coverage eligibility requirements, applied temporary spending caps, and replaced the historical cost-based payment system with a new HHA PPS in 2000. After the implementation of the HHA PPS, the number of Medicare certified HHAs increased 4.2% compounded annually from 7,528 in 2000 to 12,311 in 2012. Effective July 2013, CMS imposed a moratorium on new HHA enrollment in the Chicago, Dallas, Detroit, Houston, Miami-Dade, and Fort Lauderdale areas. This was determined due to a high risk of fraud in these areas. The moratorium was expanded in 2016 to include all of Florida, Illinois, Michigan, and Texas. As a result, the number of HHAs has declined, decreasing 1.1% compounded annually from 12,311 in 2012 to 11,356 in 2018. On January 30, 2019, CMS lifted the moratorium on new HHA enrollment in all states to improve patient access to home-based care in these regions.

"Never before have we seen such a sustained and significant emphasis from Congress and from CMS in expanding in-home healthcare services [...] While 85% of all adults and 90% of those over age 65 say that expanding home healthcare options should be a government priority."

Keith G. Myers
Co-Founder, CEO & Chairman, LHC Group
Q4 2021 Earnings Call

The Bipartisan Budget Act of 2018, signed into law in February 2018, mandated a change in the HHA PPS unit of payment from 60-day episodes to 30-day episodes and became effective January 1, 2020. The bill also requires Medicare to stop using the number of therapy visits provided to determine home health payment and continued the industry-wide transition from the fee-for-service model to a value-based model of care. The new payment method, referred to as the Patient-Driven Groupings Model, went into effect January 1, 2020.

On November 2, 2021, CMS issued the FY 2022 final payment rule for the HHA PPS which resulted in a home health payment update percentage increase of 2.6%. This was an increase from the FY 2021 final payment rule which had previously resulted in a standardized 30-day episode payment increase of 2.0%. The HHA PPS uses the latest core-based statistical area delineations and the latest available "pre-reclassified" hospital wage data collected under the ACH IPPS PPS. The wage index is applied to the labor share of the payment rate to account for differing wage levels in areas in which home health services are rendered.

Hospice Agencies ("HSPA")

The number of Medicare hospice beneficiaries increased by 3.9% compounded annually from approximately 1.2 million in 2010 to approximately 1.7 million in 2020. During the same period, the number of HSPAs increased by 3.8% compounded annually from 3,498 in 2010 to 5,058 in 2020. The increase in HSPAs is primarily attributable to growth in for-profit hospice providers which increased from 1,958 hospices in 2010 to 3,680 hospices in 2020, or approximately 6.5% compounded annually. This can be compared to the number of nonprofit hospices and hospices with government or other ownership structures which decreased at compound annual growth rates of

(0.8%) and (4.1%), respectively, over the same period. In 2020, with the onset of the COVID-19 pandemic, deaths among Medicare beneficiaries increased by nearly 18% and more than 1.7 million Medicare beneficiaries (including almost half of the decedents) received hospice services from 5,058 providers.

On July 29, 2021, CMS issued the FY 2022 final payment rule for the HSPA PPS which resulted in a hospice cap amount rate increase of 2.0%. This was a decrease from the FY 2021 final payment rule which had previously resulted in a hospice cap amount rate increase of 2.4%.

COVID-19

The COVID-19 pandemic had a unique impact on the post-acute sector through a shift in historical referral patterns towards HHA and away from IRFs, LTACHs, and SNFs. Care in the home health setting provides a lower risk of virus transmission.

Various COVID-19 relief efforts were implemented for post-acute healthcare providers, including waivers that would assist post-acute facilities in handling patient overflow and the increase in telemedicine. The waivers included in the CARES Act are effective only during time periods that qualify as an emergency period under the Social Security Act. It is still not clear when these waivers will expire as the length of the COVID-19 pandemic is uncertain.

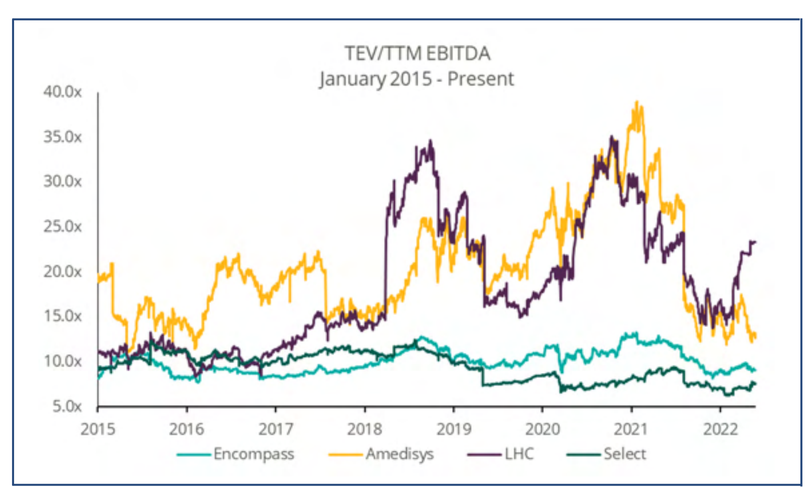
Hospital-at-Home

Hospital-at-home programs and providers have gained significant momentum in recent years, and healthcare operators look to alternative care models in a post-COVID environment. Hospital-at-home programs enable patients who need acute-level care to receive care in their homes rather than in a hospital. These programs have been shown to reduce costs, improve outcomes, and enhance the patient experience.

Several operators made headlines in 2021 including Dispatch Health, Contessa, and Medically Home. Generally, these companies acted as service providers to hospitals, HHAs, and HSPAs by offering certain acute-care services to patients who otherwise would require in-hospital care. On January 10, 2022, Medically Home announced $110 million of funding from Baxter International, Inc., Global Medical Response, and Cardinal Health. It is unknown how these investments and industry trends will impact the post-acute transaction environment, especially as U.S. payors have been slow to accept these models, but there is evidence of institutional capital pursuing these opportunities.

Transaction Activity

The chart to the right presents TEV/TTM EBITDA multiples for the major public post-acute operators as well as the VMG Health Post-Acute Index since January 1, 2015. The VMG Health Post-Acute Index consists of Encompass Health Corporation ("Encompass", formerly known as HealthSouth), Amedisys, Inc. ("Amedisys"), LHC Group ("LHC"), and Select Medical Corp. ("Select").



With the capital costs and regulatory pressure on LTACHs and IRFs, as well as the continued shift toward lower-cost outpatient settings, M&A volume for HHAs and HSPAs has remained elevated relative to IRFs and LTACHs. This trend can be seen in the portfolio mix of the large post-acute providers – Encompass, Amedisys, LHC, Select, and Kindred. Of facilities owned by these companies from 2013 to 2021, the total number of LTACHs has decreased 3.1% compounded annually, the total number of IRFs has increased 7.5% compounded annually, the total number of HHAs has increased 9.5% compounded annually, and the total number of HSPAs has increased 26% compounded annually.

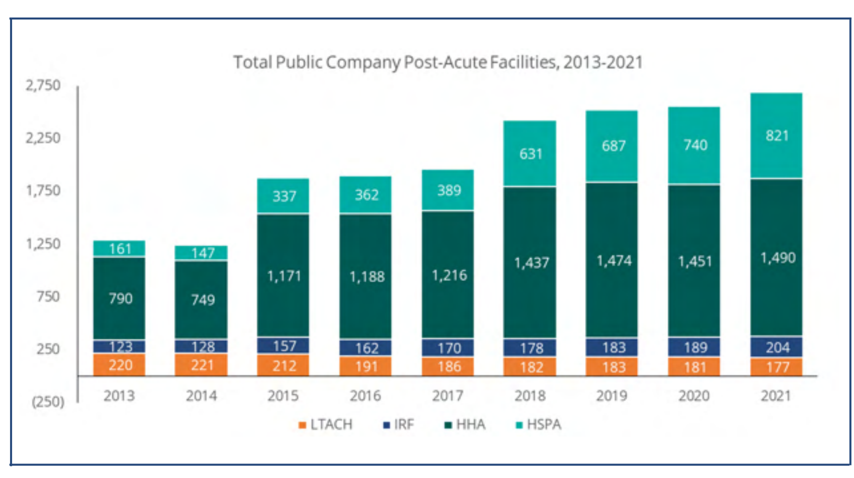
> "I think we demonstrated in a very tangible way that we're continuing to move forward to capitalize on M&A growth opportunities in home health and hospice... we do believe that the growth pipeline via M&A in both home health and hospice remains attractive."

Douglas Coltharp

Executive VP & CFO, Encompass Health

Q3 2021 Earnings Call

It should be noted in July 2021, Humana completed the acquisition of the remaining shares of Kindred at Home for $5.7 billion. Humana had previously acquired 40% of Kindred at Home in July 2018. In December 2021, Kindred's remaining business was acquired by LifePoint Health. Facility statistics for LTACHs and IRFs owned by Kindred and HHAs and HSPAs owned by Kindred at Home are included in the chart below.



As a result of the Hospital Readmissions Reduction Program, MACRA, and the Medicare Bundled Payments for Care Improvement Initiative, hospitals are increasingly incentivized to coordinate care in the post-acute setting to reduce potential penalties that would occur if patients were readmitted or had poor outcomes. As a result, hospitals have an incentive to direct patients to better-performing post-acute care organizations and settings. Further, the historically fragmented post-acute industry has proven an opportunity for consolidation and investment from PE funds, particularly in the home health and hospice settings.

Private Equity

The transition from fee-for-service to value-based payment models, the need for scale and efficiency, and the continued emphasis on outpatient care to reduce healthcare costs attracted PE firms to the home health and hospice industry.

Like other healthcare sectors seeing increased interest from PE firms, such as behavioral health and physician medical groups, PE firms in the home health and hospice space tend to pursue a platform-building strategy. This

strategy involves taking advantage of the arbitrage opportunity between the higher EBITDA multiple typically commanded by larger home health and hospice agencies (>$5m in revenue) and the lower EBITDA multiples for smaller agencies (<$5m revenue). PE firms targeting HHAs are looking to take advantage of perceived inefficiencies in site-of-care economic differentials. They aim to capitalize on changing reimbursement models which focus on the value of care, rather than the frequency of care. Additionally, as Medicare and private insurers continue to push toward lower-cost care settings, PE firms aim to capitalize on increasing home health volumes.

In April 2022, Clayton, Dubliner, & Rice announced its intention to acquire 60% of the hospice and personal care assets of Kindred at Home from Humana for approximately $2.8 billion. 60% of Kindred at Home was previously acquired in July 2018 by TPG Capital and Welsh, Carson, Anderson & Stowe.

Joint Ventures

In recent years, hospitals and health systems have been pursuing JV arrangements in the post-acute subsector. The main drivers of this trend include hospitals looking to free up inpatient resources for services with higher margins, hospitals looking to right-size financially underperforming units, increasing regulatory and financial incentives to manage the total post-acute continuum of care, and efficiencies of scale and management expertise that large, specialized operators can bring. LHC and Encompass continued their pursuit of JVs throughout 2021, while Select increased its JV and acquisition activity relative to 2021 by expanding its LTACH and critical access hospital footprint.

On March 2, 2021, LHC and Orlando Health announced a further expansion of their JV into the St. Petersburg, Florida market. The JV will add Bayfront Home Health Services to the partnership's portfolio. The home health agency, which was already part of the LHC Group family, will align with Orlando Health's Bayfront Health St. Petersburg hospital. Orlando Health recently purchased the hospital from CHS. On April 29, 2021, LHC, in cooperation with JV partners Texas Health Resources and Methodist Health System, announced an agreement for the JV to purchase and share ownership of Regent Home Health, a provider currently serving patients and families in Fort Worth, Texas. On July 7, 2021, LHC and SCP Health announced the formation of a strategic partnership to jointly develop and deliver advanced clinical care services in the home. The partnership will provide a comprehensive offering of clinicians covering all aspects of home health care, including SNF-at-home and hospital-at-home programs. As of September 14, 2021, LHC finalized an expansion of its JV with Baptist Memorial Health Care into Arkansas, adding Elite Home Health in Jonesboro to the partnership's portfolio. The home health agency, which was already part of the LHC Group family, will align with NEA Baptist Memorial Hospital. LHC and Baptist Memorial Health Care formed their JV partnership in 2017 and share ownership of 20 home health and hospice agencies across Mississippi and Tennessee. On May 3, 2022, LHC announced it has finalized a JV partnership for in-home healthcare services with Archbold Medical Center in Thomasville, Georgia. The initial agreement was first announced by the two organizations in March.

In March 2021, Encompass and Shannon Health announced the opening of a new 40-bed IRF in San Angelo, Texas. Encompass previously announced this JV in January 2020. In July 2020, Encompass announced a JV with Covenant Health for a 73-bed IRF; the IRF is comprised of a 51-bed IRF buildout and the additional conversion of an existing IRF to a 22-bed hospital-in-hospital structure, both of which will be in Tennessee. The expected opening is planned for Q3 2022. Encompass and Covenant Health will jointly file two certificate of need ("CON") applications in conjunction with the agreement. In November 2020, Encompass was awarded a CON to build a 40-bed IRF in Shiloh, Illinois and the company anticipates the IRF will operate as a JV between Encompass and BJC Healthcare. In January 2021, Encompass announced a JV with UnityPoint Health to construct a 40-bed IRF in Moline, Illinois, which is

projected to commence operating sometime in 2022. Encompass received CON approval for the new IRF in June 2020. In February 2021, Encompass announced a JV with Ascension St. John to build a 40-bed IRF in Oklahoma. The new hospital will be the JV's second location. In June 2021, Encompass and Altru Health System announced a JV agreement for Encompass to manage the existing 23-bed inpatient rehabilitation unit located in Grand Forks, North Dakota. The existing space will be renovated to increase the private room count from 23 to 40, as well as other inpatient rehab space created. In June 2021, Encompass and HSHS Sacred Heart announced their plans to build a JV 36-bed, freestanding IRF in Eau Claire, Wisconsin. The new 36-bed IRF will replace HSHS Sacred Heart's existing 24-bed IP rehab unit. In May 2021, Encompass and Piedmont Healthcare announced a joint venture agreement for two IRFs. This includes a newly built 40-bed, freestanding IRF located in Columbus, Georgia, and a newly built 40-bed, freestanding IRF in Atlanta, Georgia inside the Piedmont Atlanta Hospital. In addition, anticipated to be effective June 2021, Piedmont Healthcare will assume partial ownership of Encompass Health Rehabilitation Hospital of Newnan in Georgia. This is a 60-bed inpatient rehabilitation hospital opened by Encompass Health in December 2014. In October 2021, Encompass Health and Baptist Health announced plans to build a 40-bed IRF in Louisville, Kentucky. CON approval was met and the new 40-bed, freestanding IRF will replace Baptist Health's 29-bed unit.

In June 2021, Select signed definitive agreements to acquire Acuity Healthcare. Acuity Healthcare owns and operates four long-term acute care hospitals and one satellite that serves regions in New Jersey and West Virginia. The acquisition also includes four joint venture partnerships with AtlantiCare, Mon Health, Virtua Health, and physician partners. The five acquired hospitals will be rebranded as Select Specialty Hospitals. Each facility will remain in its current location in Atlantic City and Willingboro in New Jersey, as well as Morgantown, Wheeling, and Weirton in West Virginia. Select and Northwest Healthcare, a subsidiary of CHS, announced a JV partnership to acquire Curahealth Tucson, a 47-bed long-term acute care hospital. Select also announced a joint venture partnership with Ascension Saint Thomas to establish a new 30-bed critical illness recovery hospital inside Ascension's Saint Thomas Hospital West in Nashville. Scripps Health joined the existing joint venture partnership between Select and UC San Diego Health in Select's 110-bed critical illness recovery hospital, Select Specialty Hospital - San Diego. In December 2021, Select announced a JV agreement with West Tennessee Healthcare to own and operate a 50-bed critical illness recovery hospital serving Madison and surrounding counties.

Notable Deals

On July 1, 2022, Encompass completed the spin-off of its home health and hospice business segment to form an independent, publicly traded company which was rebranded as Enhabit Home Health & Hospice. Encompass management cited benefits of the spin-off, which include, "enhanced management focus, separate capital structures and allocation of financial resources, better alignment of management incentives, and the creation of independent equity currencies."

There were two sizeable home health and hospice transactions in February 2021. BrightSpring Health Services, a portfolio company of PE firm KKR, acquired home health and hospice provider Adobe Healthcare from Summit Partners. The transaction had a reported valuation of $775 million according to PE Hub. Adobe has been a popular target in PE-backed home health and hospice M&A in recent years. Prior to Summit Partner's acquisition of Adobe in 2019 from Tailwind Capital, Tailwind Capital had acquired the company from Frazier Healthcare Partners in 2012.

Also in February 2021, HCA signed a definitive agreement with Brookdale Senior Living to acquire an 80% stake in Brookdale Health Services for a purchase price of $400 million, or a $500 million implied valuation for a 100% stake. Brookdale Health Services is the home health, hospice, and outpatient therapy division of Brookdale Senior Living. The division operates 57 home health agencies and 22 hospice agencies in 26 states. LexisNexis ranked Brookdale

the seventh-largest home health provider in 2020 and the home health segment alone generated over $327 million in revenue in 2020.

In July 2021, Humana completed the acquisition of the remaining shares of Kindred at Home for $5.7 billion. Humana had previously acquired 40% of Kindred at Home in July 2018 when Humana along with TPG Capital and Welsh, Carson, Anderson & Stowe acquired Kindred for $4.4 billion. This brought Humana's total investment in Kindred at Home to a total of $8.1 billion. As previously mentioned above, in April 2022 it was announced that PE firm Clayton, Dubliner, & Rice intends to acquire 60% of the hospice and personal care assets of Kindred at Home from Humana for approximately $2.8 billion.

In March 2022 it was announced that Optum intends to acquire LHC for approximately $5.4 billion. UnitedHealth Group agreed to pay $170 per share for LHC. In its announcement of the deal, Optum's CEO Dr. Wyatt Decker stated, "We have over four million patients in value-based arrangements, and we're very excited to be able to offer the services of LHC Group to these individuals." LHC has 964 locations in 37 states and reported revenue of $2.2 billion in 2021.

Conclusion & Future Outlook

Given the shift in referral patterns away from LTACHs and IRFs, along with the capital requirements and regulatory pressure, we expect M&A volume in post-acute to continue focusing on HHAs and HSPAs. The fragmented status of both the HHA and HSPA industries has left plenty of room for consolidation. The HHA and HSPA space will likely remain a seller's market, especially for larger transactions, as strategic buyers seek to incorporate the entire continuum of care and provide consumer-friendly alternatives to patients. In a post-COVID world, HHAs and HSPAs with sophisticated technological and telehealth capabilities will become increasingly popular targets.

More Post-Acute Thought Leadership

- Is There Value in Your Inpatient Rehabilitation Facility?

Behavioral Health

The U.S. behavioral health market was comprised of over 15,400 facilities in 2020 including psychiatric hospitals, general hospital specialty units, general hospital specialty units, substance abuse and mental health residential treatment centers ("RTC"), and outpatient clinics. Of the total behavioral health facilities ("BHF"), approximately 60% are operated by private nonprofit organizations, approximately 21% are operated by private for-profit organizations, and approximately 19% are in the public sector. Also of note, approximately 40% of total BHFs are outpatient mental health facilities, 21% are community mental health centers, 7.9% are general hospital specialty units, 6.6% are RTCs, and 5.4% are psychiatric hospitals. The remaining 19% are RTCs for children, veteran administration medical centers, multi-setting mental health facilities, partial hospitalization or time treatment facilities, and other types of BHFs.

The largest behavioral health companies in the United States are publicly traded Acadia Healthcare Company, Inc. ("Acadia") and publicly traded UHS. As of Q3 2021, Acadia's U.S. operations had 230 BHFs with approximately 10,200 beds in 40 states (including Puerto Rico). In 2021, UHS' U.S. and United Kingdom operations had 335 BHFs and approximately 24,000 beds.

"We believe that the fragmented behavioral health care industry offers additional prospects for future acquisitions, and we are well positioned with sufficient capital to pursue these opportunities.

Debra K. Osteen
CEO & Director, Acadia
Q3 2021 Earnings Call

Industry Trends

The behavioral health industry is highly fragmented, and attractive to private equity investors due to its capital-lite operating model and recent history of improvements in reimbursement.

Improvements to reimbursement began with the SUPPORT for Patients and Communities Act ("SUPPORT") in October 2018. The bill is one of the most significant legislative overhauls addressing a substance abuse epidemic in recent history. SUPPORT is expected to be a tailwind to the behavioral health industry, and specifically, operators focused on the treatment of substance abuse disorders. Highlights expected to affect transaction activity include:

- All state Medicaid programs will be required to cover medication-assisted treatment ("MAT"), including related counseling and behavioral health services for FY 2020 through FY 2025;
- States can use Medicaid funds to cover patients with at least one substance use disorder ("SUD") for up to 30 days over a 12-month period for FY 2019 through FY 2023;

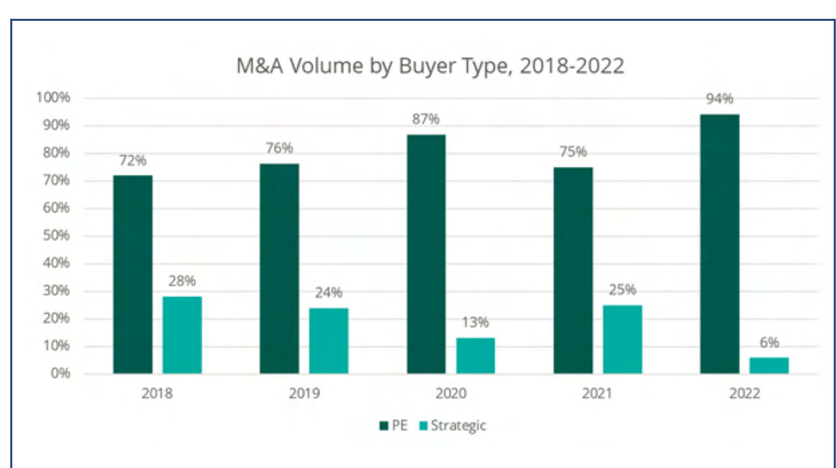
- Expansion of Medicare coverage to include Opioid Treatment Programs for services provided on or after January 1, 2020;
- Expanded access to MAT by increasing the number of patients a physician or qualified practitioner can treat with buprenorphine, a MAT drug, at any one time;
- Looser restrictions on the types of providers who can prescribe MAT;
- The Eliminating Kickbacks in Recovery Act of 2018 ("EKRA") seeks to impose criminal liability for conduct similar to the conduct targeted by Stark Law's Anti-Kickback Statute but in the context of addiction treatment and recovery services. EKRA is applicable to all forms of payment, not just government payments.

Funding through the CARES Act allocated $425 million to the Substance Abuse and Mental Health Services Administration to fund initiatives including but not limited to: Certified Community Behavioral Health Clinic Expansion Grant program ($250 million), suicide prevention programs ($50 million), emergency response services in local communities ($100 million), tribal and urban Indian health organizations ($15 million), and other services ($10 million).

In early 2022, CMS expanded and extended Medicare coverage for behavioral health-related telehealth services through the MPFS. Most notably, CMS permanently expanded coverage for the diagnosis, evaluation, or treatment of certain mental health disorders to include services delivered to beneficiaries located in their homes. CMS also permanently expanded coverage for audio-only telecommunications for mental health disorders when certain conditions are met.

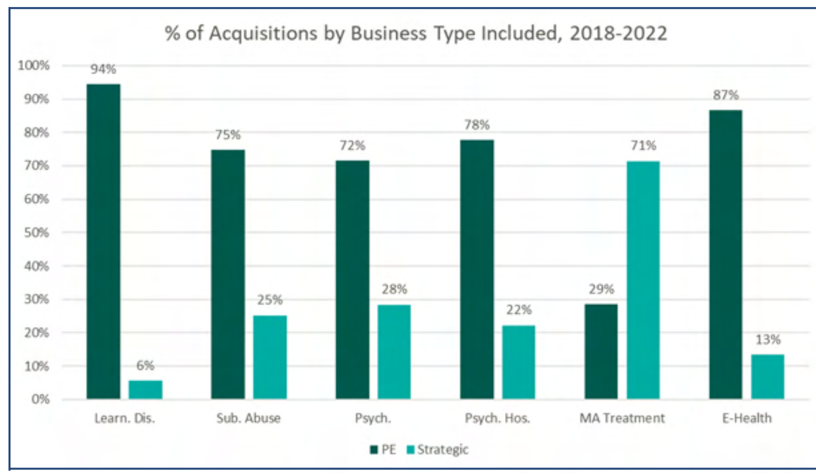
Historically, many BHF and providers utilized an out-of-network strategy given unsustainable reimbursement from payors. With increasing regulatory pressure against these out-of-network strategies (e.g., No Surprises Act), behavioral health providers will seek additional scale through consolidation. Increased consolidation in the sector is intended to achieve more favorable reimbursement from commercial payors.

While some trends contributing to the increase in the transaction space are unique to behavioral health (e.g., declining stigma), other factors are widespread throughout the health care sector (e.g., labor market pressures and inflation). Declining stigma drives increased demand for mental health services and increased operational complexity.



Private Equity

PE has led the recent deal activity in the behavioral health sector given its fragmented nature, lack of scale, and growing demand for services following the height of COVID-19. Transaction volume accelerated in 2021 and early 2022 with PE buyers comprising more than two-thirds of deal volume as reported by Irving Levin, Pitchbook, and Scope Research. Unlike other healthcare sectors, many behavioral health disorders can be treated in relatively capital-lite facilities capable of high patient volumes. Examples include addictions and autism-based disorders.



Notable deals include Patient Square Capital's acquisition of Summit BHC for approximately $1.3 billion. Summit BHC was sold to Patient Square Capital from FLL Partners and Lee Equity which originally made its investment in 2017.

At the beginning of the year, Summit BHC announced it had closed on a deal to acquire seven psychiatric hospitals from Strategic Behavioral Health. The terms of the deal were not disclosed.

In July 2021, Onex Partners took a 60% controlling interest in Newport Healthcare which valued the business at $1.3 billion. Newport Healthcare is a teen-focused mental health platform and was formerly backed by The Carlyle Groups US Equity Opportunity Fund.

Medical Properties Trust, a real estate investment trust, committed $950 million to the purchase and leaseback of 18 inpatient behavioral health hospitals and an equity interest in the operations of Springstone, LLC from Welsh, Carson, Anderson & Stowe.

Joint Ventures

High levels of recent transaction volume can be primarily attributable to recent regulatory changes including CARES Act funding and the No Surprises Act. Additionally, the ongoing opioid crisis has only been exacerbated during the COVID-19 pandemic and an abundance of investment capital for behavioral health companies has strengthened the strong transaction environment. Collectively, these external pressures have led to an increase in the number of JVs between nonprofit health systems and for-profit companies, like Acadia and UHS, to operate full-service behavioral health hospitals. Nonprofit health systems view the JV model as an attractive opportunity to relieve occupancy issues for hospitals by shifting services to off-site locations, leveraging financing for for-profit operators to upgrade outdated facilities, and generating increased profitability through the operational focus and expertise of the for-profit operators through a management services agreement. The behavioral health for-profit operators are provided an entry into new markets with the assistance of established care delivery networks' existing footprint of providers and the health system's access to better existing commercial and medical supply contracts.

Acadia and UHS have historically been the key players pursuing this strategic JV model, however, other for-profit companies like Kindred Healthcare have begun to establish similar JVs in the post-acute behavioral health sector. Established in 2019, Kindred Behavioral Health Services ("KBHS") has already developed over 30 JVs with specialty hospitals across the country. In 2020, KBHS joint ventured with Baystate Health in Western Massachusetts to build a $43 million, 120-bed behavioral health facility. In May of 2022, KBHS announced a plan to partner with Tampa General to operate a new freestanding, 96-bed unit with the potential to expand to 120 beds.

Challenged by the broader labor shortages, UHS has communicated an increased selectivity in the selection of partnership opportunities. In February 2021, UHS partnered with MercyOne to open the Clive Behavioral Hospital, an 83,000-square-foot, 100-bed psychiatric hospital in Clive, Iowa. Also in February 2021, UHC announced a partnership with Southeast HEALTH to open a 102-bed psychiatric hospital in Cape Girardeau, Missouri. At the

beginning of 2022, two additional hospitals opened in Michigan and Wisconsin through a partnership with Beaumont Health, and another facility is expected in the second half of 2022 through a partnership with HonorHealth in Arizona.

"There are a lot of JV opportunities, situations that we look at and pass on, because we just don't see the merit long-term. If you notice the ones that we do, for the most part, are recognizable, nationally known names or they're very strong regional players, and that's purposely done."

Marc D. Miller
CEO, Universal Health Services
Q4 2021 Earnings Call

Acadia anticipates that it will add 600 new beds in 2022 through different channels and has provided long-term guidance that it expects to add between 600 and 1,100 beds in the following two years. This projected growth comes after adding 681 new beds in 2021 through the expansion of existing facilities, JVs with other healthcare systems, mergers and acquisitions, and the addition of de novo facilities. Acadia has two JVs currently projected to open in 2022 with anticipation that the company will ramp up to four or five a year in 2023 and 2024. In July of 2021, Acadia announced a deal to open a 96-bed JV facility in Battle Creek, Michigan with Bronson Healthcare that is set to begin operations in 2023. In November of 2021, Acadia announced a JV with Scripps Health to build a 120-inpatient bed hospital in Chula Vista, California that is scheduled to open in 2023. In December of 2021, Acadia announced a JV with Orlando Health, a 16-hospital system with approximately 3,200 beds, to help manage and expand their behavioral health services to residents in Central Florida and the Southeast.

Conclusion & Future Outlook

The behavioral health industry has been and will continue to be on the front lines of treating the U.S. mental health and substance abuse epidemic while also emerging as a leader in virtual healthcare delivery. Companies with a proven ability to provide services through virtual means will be popular acquisition targets. An increase in mental health disorders caused by the pandemic and recent economic downturn is expected to persist long after COVID-19 subsides and will likely benefit behavioral health facilities in the long term.

More Behavioral Health Thought Leadership

- Now Trending in Behavioral Health: Integration Strategy, Regulatory Compliance, & Transactions
- Behavioral Health Joint Ventures: Recent Activity & Key Considerations

Urgent Care

The number of urgent care centers ("UCCs") in the United States has grown 7.5% compounded annually from 6,100 UCCs in 2013 to 10,115 UCCs in 2020. In May 2021, the most recent data available showed that there were approximately 10,463 UCCs and implied an 8.5% run rate for urgent care growth this year.

The urgent care market is highly fragmented with the top ten providers accounting for approximately 20% of the total UCC locations. As of May 2022, Concentra (subsidiary of Select) was the largest operator of UCCs with 518 locations, an increase from approximately 300 locations in 2015 which represents a 10% compound annual growth rate. American Family Care, the second largest operator, operates over 280 locations and has indicated the goal to operate over 500 clinics by 2025.

The growth in urgent care locations is driven by increased demand. Urgent care visit volumes continue to outpace other sites of service driven by several macro factors. First, consumers continue to demand accessible, on-demand health services. Second, patients are bearing more financial responsibility for their own healthcare leading to increased price scrutiny. Third, patients are expecting a digital healthcare experience in line with their online retail digital experience (i.e., Apple, Amazon, etc.). Lastly, many large commercial payors are changing their policies and limiting what qualifies as a reimbursable visit to the emergency room. An emergency room visit is approximately 10 to 12 times the cost of an average urgent care visit, according to the U.S. Department of Health. These factors have led to the transition of patient volume from the emergency room (some freestanding) to the urgent care setting.

The demand for urgent care services continues to make UCCs attractive acquisition targets. UCCs typically can provide both strategic and financial buyers positive investment returns through the expansion of an existing platform and/or operational changes. The average urgent care organization has only three urgent care locations. This allows consolidators the opportunity to generate financial returns through economies of scale. For financial buyers, optimizing the staffing model with lower-cost mid-level providers is the most common operational change that is pursued. However, this varies by location as state laws regulate the amount of physician oversight required in individual UCCs.

COVID-19

UCCs were at the forefront of treatment and testing services throughout the COVID-19 pandemic. After initial volume disruptions during the early onset of the pandemic, UCCs experienced significant increases in testing volumes and new patient visits. Average patient visits per clinic ("APVC") reached record highs during summer 2020 as UCCS ramped up testing capabilities and adopted telehealth services. Over 70% of UCC visits in December 2020 were COVID-19-related, and in February 2021 this percentage dropped below 60% for the first time since September 2020. UCCs with COVID-19 testing capabilities retained more volume than those without testing capabilities.

In addition to the increased visit volumes, the patient mix between new and established patients shifted. Prior to April 2020, the patient mix between established visits and new visits averaged approximately 60% established patients and 40% new patients. After April 2020 and into 2021, new patient visits became a greater ratio of total visits following COVID-19 spikes and represented over 50% of the patient visit mix. This mix shift had an impact on reimbursement for many UCCs, and 52% of clinics saw an increase in average net revenue per visit in 2020 as new

patients were reimbursed at a higher rate than established patients. The increase in reimbursement was partially offset by a rise of “no visit” patients where an E&M code was not billed (e.g., only testing services performed).

Net Patient Revenue per Visit	2019	2020	Change
Established Patient	$121.92	$123.00	**0.9%**
New Patient	152.24	150.72	**(1.0%)**
No Visit	54.75	60.99	**11.4%**
Average	118.51	121.62	**2.6%**

“Urgent cares have a significant dual-opportunity to grow business revenue while also serving as an invaluable care access point for the masses.”

David Stern

CEO, Experity

February 2022 Forbes Business Council Post

The future of UCC volumes is uncertain. In January 2022, through funding from the American Rescue Plan, at-home COVID-19 testing kits were offered online for free. As of May 2022, over 70 million households have visited COVIDTests.gov to order free at-home tests and 350 million tests have been delivered through the program. The program has offered several rounds of free at-home testing mailed through USPS, with eight additional tests approved for distribution as of May 17, 2022. In addition, pharmacies, online stores (e.g., Amazon), and retail locations have expanded the accessibility of at-home testing kits. Patients turning to at-home testing alternatives for COVID-19 symptoms could directly impact UCCs, and the elevated patient visit volumes experienced during 2021 could begin to decline throughout the end of 2022 and 2023. Alternatively, COVID-19 volumes could remain a component of UCC volumes due to new viral variants and seasonal peaks.

Influenza-Related Volumes

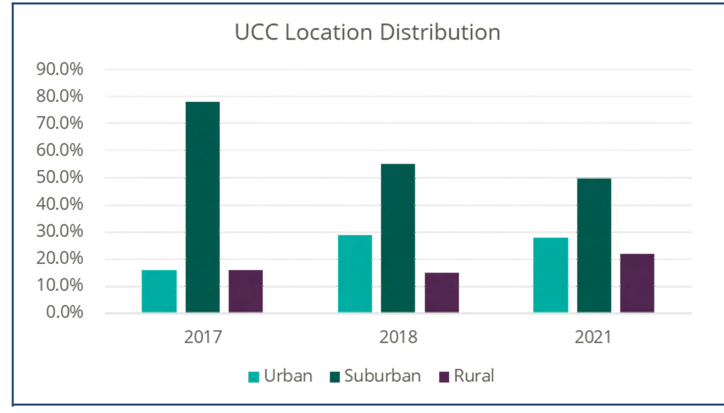
Year	Medical Visits	Hospitalizations
2016	14,000,000	500,000
2017	21,000,000	810,000
2018	17,000,000	490,000
2019	18,000,000	400,000
2020	n/a	215

Historically UCCs' patient visit volume experienced seasonality with flu season (higher volume) and summer months (lower volumes). In 2020 and 2021, the number of hospitalizations for influenza declined dramatically from a historical average of 550,000 annual hospitalizations to 215 in 2020. Epidemiologists attribute this dramatic decrease in flu cases to an equally dramatic decrease in international travel (new flu strains historically originate in Southeast Asia). In addition, domestic social distancing, mask usage/mandates, and other patient behavior limited typical flu exposure. As of April 2022, non-COVID-19 visit volumes were at 72% of pre-COVID-19 levels. The potential future loss of COVID-19 volumes for UCCs could be offset by the recovery of these non-COVID-19 visits.

UCCs supported by COVID-19 testing and treatment volumes may experience financial distress if patients turn to alternative testing sources and non-COVID-19 volumes do not recover. These locations could seek to partner with a larger organization and become tuck-in acquisition targets in the next year. At the same time, UCCs who remain profitable despite COVID-19 volume variability will also be attractive acquisition targets.

Market Saturation

The UCC market is becoming more saturated with the top 50 U.S. Census core-based statistical areas ("CBSA") having approximately 2.8 UCCs per 100,000 people in 2019 (the latest data available). This is an increase from 2.7 in 2018. Close to half of the top 50 CBSAs have 3.0 UCCS per 100,000 people and 10 CBSAs have over 4.0 UCCs per 100,000 people. Approximately 90% of the U.S. population is within a 20-minute drive of a UCC, and 80% of the population is within a 10-minute drive.



Market saturation in the UCC sector is most prevalent in large suburban metro areas with suburban UCC operators representing approximately 50% of total UCCs. However, the ratio of locations in rural areas has grown in recent years as certain operators focus on rural health strategies.

Despite the market saturation, there is a significant increase in demand which can be measured through the average ramp-up time for de novo clinic locations. Average startup location volumes historically averaged between 10 to 20 visits per day in the first six months of operations for de novo locations opening between 2016 and 2019. Volumes for these locations stabilized at approximately 30 to 40 patients per day after 18 to 24 months. However, startup locations that opened in 2021 saw an average of 32 patients per day in the first month, and 60 visits per day after just six months.

Private Equity

PE investors deployed capital for new urgent care platforms during 2021. These platforms are expected to continue to pursue tuck-in acquisition and other high-growth strategies.

ICV Partners ("ICV") completed the acquisition of Total Access Urgent Care ("TAUC") in February 2021. TAUC was physician-founded in 2008 and operates 26 clinics throughout the Midwest. The partnership announced the goal to open 11 additional clinics throughout 2021. ICV completed the acquisition of Urgent Care Group in March 2022 as the first add-on acquisition to the Total Urgent Care platform. Urgent Care Group was founded in 2017 and operates 24 urgent care locations in the North Carolina, Atlanta, and South Carolina markets. The combined platform now operates more than 50 urgent care locations with continued expansion plans through de novo opportunities and acquisitions.

"Our new partnership [...] positions us well to execute on our plan to open an additional 11 locations by the end of 2021."

Dr. Troy Dinkel
President & Chief Medical Officer, Total Access Urgent Care
February 2021 Press Release

In December 2021 Quilvest Capital Partners announced an investment in UrgentMED, an urgent care platform with 35 locations in Southern California, including Orange County, Los Angeles County, and Ventura County. UrgentMED was founded in 2007 by physicians who will retain ownership and leadership roles in the company going forward.

One of the largest UCC transactions completed this year was the expansion of a private equity-backed urgent care platform. In April 2021, Tenet completed the sale of its urgent care platform to FastMed Urgent Care for $80 million. Tenet's urgent care platform was operated under the CareSpot and MedPost brands and managed by USPI. The transaction adds 87 UCCs to FastMed's existing portfolio of 104 UCCs, making FastMed one of the top five urgent care chains by the number of locations in the United States. The acquisition also expands FastMed into Florida and California where most of the acquired centers are located. Tenet leadership noted the acquisition will allow Tenet and USPI to focus on the continued growth and expansion of their ambulatory surgical services.

Following the urgent care M&A boom of 2015, transaction activity slowed down due to buyers' need to digest recent UCC purchases. PE firms were highly active buyers during this boom. Since PE firms typically hold their investments for three to seven years, there is a possibility that increased M&A activity fueled by PE exits is on the horizon. The table below shows the largest non-hospital-owned urgent care operators in the U.S. Of these, seven are currently backed by a PE firm. Of the seven PE-backed urgent care operators, six are within or exceeding the typical investment window ("vintage"), which indicates a potential exit opportunity in the near future.

Urgent Care Chain	Locations	Type	PE Firm	Vintage
Concentra	500+	Private Equity	Welsh, Carson, Anderson & Stowe; Cressey & Co.	7 years
American Family Care	280+	Franchise	n/a	n/a
FastMed	190+	Private Equity	ABRY Partners; BlueMountain Capital Management	7 years
MedExpress	170+	Payor	n/a	n/a
Fast Pace	160+	Private Equity	Revelstoke Capital Partners	6 years
GoHealth	160+	Private Equity	TPG Capital	8 years
NextCare	155+	Private Equity	Enhanced Capital Partners	12 years
CityMD	135+	Private Equity	Warburg Pincus	3 years
WellNow Urgent Care	110+	Independent	n/a	n/a
Patient First	75+	Independent	n/a	n/a
Urgent Team	70+	Private Equity	Crestline Investors	6 years

In January 2022, HCA announced the completion of the acquisition of MD Now Urgent Care, the largest urgent care provider in Florida with 59 locations. HCA announced in November 2021 the plan to build three hospitals in the state and the platform of urgent care locations will assist HCA with its goal of providing a comprehensive statewide network of care in the Florida market. MD Now Urgent Care was acquired from Brentwood Associates,and concluded an approximate 3.5-year holding period. HCA continued to be active in the urgent care transaction space. In April 2022, HCA signed an agreement to acquire BetterMed, a 12-location urgent care platform in Richmond, Virginia. The deal is expected to close in 2022. HCA will own and operate over 250 locations with the combination of the CareNow network of urgent care centers (185) and these two recent acquisitions (59 and 12 locations).

In May 2021, ConvenientMD announced a strategic partnership with Bain Capital to support the continued growth of the platform. ConvenientMD operates 26 urgent care locations in rural and suburban markets across New Hampshire, Maine, and Massachusetts. The transaction concludes a two-and-a-half-year holding period of ConvenientMD by Starr Investment Holdings, which acquired the company in 2018 with 11 locations.

Health System Transactions

In addition to HCA, other health systems played an active role in the urgent care transaction space during 2021. A popular strategy for many health systems was to pursue joint ventures with strategic operators.

In March 2021, Trinity Health announced the acquisition of a majority stake in Premier Health, a national urgent care operator with over 70 locations. Premier Health is based in Baton Rouge, Louisiana, and specializes in a joint venture partnership model with local health systems. The Premier Health locations will continue to be branded and partner with the local health systems. The combined partnership will also manage 20 of Trinity Health's existing urgent care locations and intends to double the number of clinics operated across several states in the next few years.

"With Trinity Health as a strategic partner, Premier Health will move forward with an ambitious growth plan that will more than double our nationwide urgent care footprint with locations in at least 20 states."

Steve Sellers
CEO, Premier Health
March 2021 Press Release

Memorial Hermann also announced a JV with a strategic operator in April 2022. Memorial Hermann will contribute 10 clinics, including one dedicated pediatric location, to a partnership with GoHealth Urgent Care in the Houston, Texas market.

Other Buyers

In addition to PE and health systems, 2021 saw new entrants in the urgent care buyer pool. Carbon Health is a tech-enabled healthcare company with the goal of combining virtual app-based services with brick-and-mortar primary care clinics. The company became an active buyer of urgent care locations and small urgent care platforms. Carbon Health's goal is to have "1,500 primary care clinics by 2025" and become the largest primary care provider in the U.S. In July 2021, Carbon Health completed a $350 million fundraising round valuing the company at $3.3 billion. Following the investment, Carbon Health completed the following urgent care transactions in 2021 and early 2022:

- Med7 Urgent Care – four clinic urgent care business in the California market (August 2021)
- South Arizona Urgent Care – nine location urgent care business in Arizona (August 2021)
- Central Jersey Urgent Care – 10 location urgent care business in New Jersey (October 2021)
- MedPost California – Acquired 17 of MedPost's California locations from Orange County, Palm Desert, and Paso Robles (April 2022)

Carbon Health currently operates over 120 primary care or urgent care clinic locations with continued expansion plans in the future. Entities looking to acquire primary care/risk-based businesses could mirror Carbon's brick-and-mortar strategy and become competitors for urgent care transactions.

Reimbursement

UCCs are reimbursed by Medicare according to the MPFS. On November 2, 2021, CMS released the CY 2022 MPFS payment and policy changes final rule. The CY 2022 Medicare conversion factor was reduced by approximately 3.7% from the CY 2021 MPFS final rule. This was largely due to the expiration of the 3.8% payment increase provided by the Consolidated Appropriations Act of 2021.

Established by Congress in the Balanced Budget and Emergency Deficit Control Act of 1985, Medicare payment sequestration was put in place to reduce government spending to meet budgetary goals. In December 2021, Congress approved the Protecting Medicare and American Farmers from Sequester Cuts Act, and effectively eliminated the mandated 2.0% Medicare Payment sequestration until April 1, 2022. Congress implemented a 1.0% reduction to all Medicare payments to move forward with federal sequestration cuts on April 1, 2022, with the 2.0% sequestration scheduled to begin July 1, 2022.

Conclusion & Future Outlook

From a financial perspective, the urgent care industry was positively impacted by the rise of COVID-19 testing volumes throughout 2021. The sustainability of these volumes could be at risk throughout 2022 and 2023 as COVID-19 volumes decline and at-home testing capabilities increase. If that does happen, it could put financial pressures on recently opened or smaller UCCs. In addition, the UCC industry is not immune from other risks facing the healthcare industry and the U.S. economy such as the current labor market and supply cost inflation pressures.

However, these risks could be mitigated by several factors. Patients who came to clinic sites for COVID-19 testing are more likely to return to that location in the future. The ease of COVID-19 precautions (e.g., masks, social distancing, etc.) could result in the return of typical urgent care visit types. Technological advancements (e.g., adoption of telehealth capabilities) could result in operational efficiencies and a competitive advantage for some UCCs. Finally, the UCC industry will continue to experience growth due to macro factors such as the rise in consumerism, patient expectations, and payor pressures to redirect emergency room visits to lower-cost sites of care.

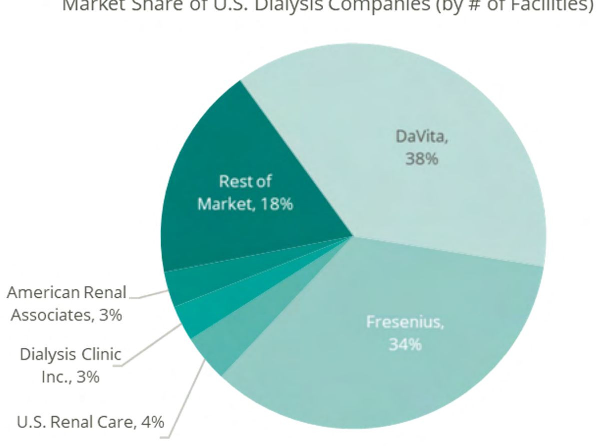
Strong M&A activity and transaction volume is expected to continue as PE buyers exit historical investments, platforms seek tuck-in acquisition opportunities, and health systems and other entities expand their outpatient and primary care service areas. UCCs proved their resiliency and flexibility in providing patient care throughout the COVID-19 pandemic. UCC operators with sophisticated telemedicine capabilities, COVID-19 testing, and the ability to adapt to changes in patient visit types will be popular acquisition targets in the future.

Dialysis

Following years of relative stability in the dialysis and broader kidney care industry, a shakeup is beginning to unfold due to legislative directives prioritizing care outside of traditional dialysis facilities and a growing number of consolidators on the nephrology practice side. These emerging trends have resulted in a slowdown of the growth rate of traditional in-center hemodialysis and an increased prevalence of home-based kidney care, as well as the introduction of new value-based kidney care models. These two trends are poised to continue to drive innovation and change in this industry.

Historically, dialysis care has been dominated by hemodialysis offered in outpatient dialysis centers. As of the most recent data published by CMS, there are approximately 7,800 dialysis centers in the U.S. The number of outpatient dialysis centers has grown at a compound annual growth rate of 3.7% over the last 10 years, increasing from 5,413 dialysis facilities in 2010 to 7,800 in 2020. More recent growth has slowed relative to years prior with only 1.0% growth in the number of facilities occurring between 2019 and 2020. This came after the prior 2015 to 2019 period experienced an average annual growth of 4.0%.

As of 2020, approximately 95% of dialysis facilities were freestanding and the remaining 5.0% were hospital-based. The number of hospital-based facilities has shown negative growth rates during the most recent five years. However, free-standing facilities have consistently increased in number, but the rate of growth did slow significantly in 2020. Although CMS has not published data regarding the number of dialysis centers for 2021, guidance from the large, publicly traded operators would indicate continued lagging growth in 2021.



In comparison to most other healthcare verticals, the dialysis industry is highly consolidated and is dominated by two large dialysis operators, DaVita, Inc. ("DaVita") and Fresenius Medical Care ("Fresenius"). When combined these companies operate 72% of the dialysis facilities in the United States. DaVita's business is focused primarily on operating dialysis facilities and is headquartered within the U.S. Fresenius' parent company is headquartered in Germany and operates other related businesses in addition to dialysis facilities. The next largest three operators combine to account for only 10% of the remaining market share in the U.S., and each operates roughly 3.0% to 4.0% of total U.S. dialysis facilities. These include U.S. Renal Care (4.0%), American Renal Associates (3.0%), and Dialysis Clinic Inc. Dialysis Clinic Inc. operates approximately 3.0% of facilities and is the largest nonprofit operator of its kind. The rest of the market is comprised of single-site or smaller multi-site independent operators which account for the remaining 18% of outpatient dialysis facilities in the U.S.

COVID-19

In 2020 and 2021, the two prominent dialysis facility operators, DaVita and Fresenius, communicated that given the average age and relative health of dialysis patients there were significantly higher mortality rates from COVID-19 observed among individuals receiving treatment at their dialysis facilities. Additionally, COVID-19 infections also contributed to an increase in the number of missed treatments among existing patients. Both factors contributed

negatively to overall treatment volumes. Continuing surges in infection rates due to COVID-19 variants have been noted by DaVita as contributing to softer overall treatment volumes throughout 2021. It is evident that when compared to many other healthcare provider verticals the impact of COVID-19 continues to play a prominent role in the dialysis industry.

Fresenius and DaVita both noted in Q4 2021 earnings calls that the core drivers of their medium- and long-term business prospects remain unchanged and new patient starts are showing positive trends despite the lingering impact of COVID-19 amongst existing patients. As the population in the U.S. continues to age and there is an increased incidence of contributing risk factors for End-Stage Renal Disease ("ESRD"), such as hypertension and diabetes, there will continue to be growth in the long-term for dialysis care providers.

"We're going to see some movement in people trying to band together where they can cover their weaknesses by who they might partner with."

Robert Maurice Powell
Chairman of the Management Board & CEO of Fresenius Medical Care Management AG, Fresenius Medical Care AG & Co. KGaA
Q1 2022 Earnings Call

Transition to Home Dialysis

Center for Medicare and Medicaid Innovation ("CMMI")'s ESRD Treatment Choices ("ETC") Model is a new payment model which applies to a selected subset of dialysis facilities and nephrology providers representing approximately 30% of total adult dialysis beneficiaries. This model is mandatory for those participants selected and went into effect in January 2021. The model will continue through June 30, 2027. The goal of the ETC model is to promote home dialysis and kidney transplantation using adjustments to the payments that providers and dialysis facilities receive. These payments are generally expected to be positively influenced by relatively higher proportions of home dialysis treatments for participating facilities.

The larger facility operators have continued to invest in opportunities and services that will contribute to growth in home dialysis and allow them to benefit from the ETC model's payment structure. DaVita indicated during its Q4 2021 investor earnings call that home dialysis treatments grew 3.0% relative to 2020 levels, with home treatments representing 15% of overall treatment volumes during FYE 2021. Fresenius indicated home dialysis treatments also accounted for approximately 15% of overall treatment volumes during Q4 2021 and its expectation is by 2025 it can reach a target of 25% of overall treatments occurring at home.

Robert Maurice Powell
Chairman of the Management Board & CEO of Fresenius Medical Care Management AG, Fresenius Medical Care AG & Co. KGaA
Q1 2022 Earnings Call

"I still think home is going to be hot, hot, hot. I think it's really going to be something that's going to grow and take off."

Value-Based Care & Provider Collaboration

Value-based care, shared savings arrangements, and ACOs have become more prevalent among many types of healthcare providers in recent years. In addition, ESRD care providers have their own opportunity to participate and potentially benefit through the Kidney Care Choices ("KCC") Model. There are four KCC model options. The Kidney Care First option is open to participating nephrologists, nephrology professionals, and nephrology practices. This option allows participants to receive adjusted capitation payments for managing the care of aligned beneficiaries with Chronic Kidney Disease ("CKD") Stage 4 or 5 (a precursor to ESRD), and for those who are on dialysis.

There are also three alternative options under the Comprehensive Kidney Care Contracting ("CKCC") models. These options allow nephrologists to partner with transplant providers and dialysis facilities to form Kidney Care Entities ("KCEs"). KCEs are eligible to receive monthly and quarterly capitated care management payments, as well as transplant bonus payments similar to the capitation payments under the Kidney Care First option. However, KCE stake responsibility for the total cost and quality of care for their patients, and in exchange, they can receive a portion or all the Medicare savings they achieve. The first cohort of KCC Model participants began their participation in the model performance period on January 1, 2022.

Notable Deals

In January 2021, Innovative Renal Care completed its acquisition of American Renal Associates ("ARA") and took ARA private for an implied enterprise value of $1.3 billion. The transaction, announced in October 2020, had an implied TEV/Revenue multiple of 1.6x and an implied TEV/EBITDA multiple of 8.1x. Innovative Renal Care is a portfolio company of private equity firm Nautic Partners. ARA traded on the New York Stock Exchange prior to the transaction. Through the transaction, the PE firm Centerbridge Partners completely exited the investment in ARA that they made in 2010. Centerbridge Partners took ARA public in 2015 through an IPO.

In 2021, DaVita acquired the transplant software company MedSleuth to ease access burdens on kidney and liver transplant candidates. MedSleuth's products will not be used by DaVita's providers or at its clinics but will continue to be used by MedSleuth clients at transplant centers. Although the acquisition does not directly integrate with its dialysis facility focus, it does create a more robust portfolio of organizations under their umbrella involved in the care for individuals with CKD and ESRD. In addition to MedSleuth, DaVita acquired 19 dialysis centers in the U.S. during 2021. This was an increase from eight acquired in 2020 and seven acquired in 2019.

DaVita closed 30 dialysis centers during the fourth quarter of 2021, which was noted to be higher than the number normally closed during a full year. Overall closures were higher for the year, and management indicated that a mixture of factors contributed to these closures. Some factors included the change expected in the mix of home versus in-center treatments and the impact of higher mortality rates from COVID-19. Management indicated that they would continue to build fewer de novo facilities and continue to grow their portfolio of home-based care centers.

Fresenius' value-based care division entered a three-way merger with two U.S. providers of kidney care, InterWell Health and Cricket Health. The new company was valued at over $2.4 billion. It will be fully consolidated by Fresenius Medical Care as the majority owner but will operate under the InterWell Health brand. The company aims to engage and manage the care of more than 270,000 people with kidney disease by 2025.

Reimbursement

On October 29, 2021, CMS released the CY 2022 ESRD PPS policy changes and payment rates final rule. Based on the final ruling, the ESRD PPS base rate will increase from the CY 2020 base rate of $253.13 to the new rate of $257.90. Both DaVita and Fresenius noted in Q4 earnings call discussions that the increase was moderately surprising and the 1.9% growth over the prior year was unexpected. CMS projects total payments to hospital-based ESRD facilities to increase by 2.5% and total payments to freestanding facilities to also increase 2.5% relative to CY 2022 levels. Additionally, the rule finalizes modifications to the ETC Model policies to encourage certain health care providers to decrease disparities in rates of home dialysis and kidney transplants among ESRD patients with lower socioeconomic status.

Conclusion & Future Outlook

Despite uncharacteristic sluggish growth over the past two years resulting from the challenges which continue to be presented by the COVID-19 virus, operators in the dialysis industry remain bullish on their future growth prospects. The industry's major operators have expressed their belief that the core drivers of new patient growth in the dialysis industry remain unchanged and unequivocally positive. High growth is expected to continue with home hemodialysis and peritoneal dialysis services and many providers have made significant investments in fostering growth in this service line. The two largest dialysis operators, jointly accounting for 73% of the total market, will continue to take pole position as industry leaders in the dialysis and kidney care M&A market. Both have made significant investments in introducing home-based services and have embraced the novel value-based care models. Market observers should continue to watch the myriad of emerging consolidators on the nephrology practice side. Backed by significant private equity investment, these emerging companies are seeking to consolidate a fragmented industry and leverage technology, analytics, and scale to accelerate the introduction of value-based care and shared-risk models.

Oncology

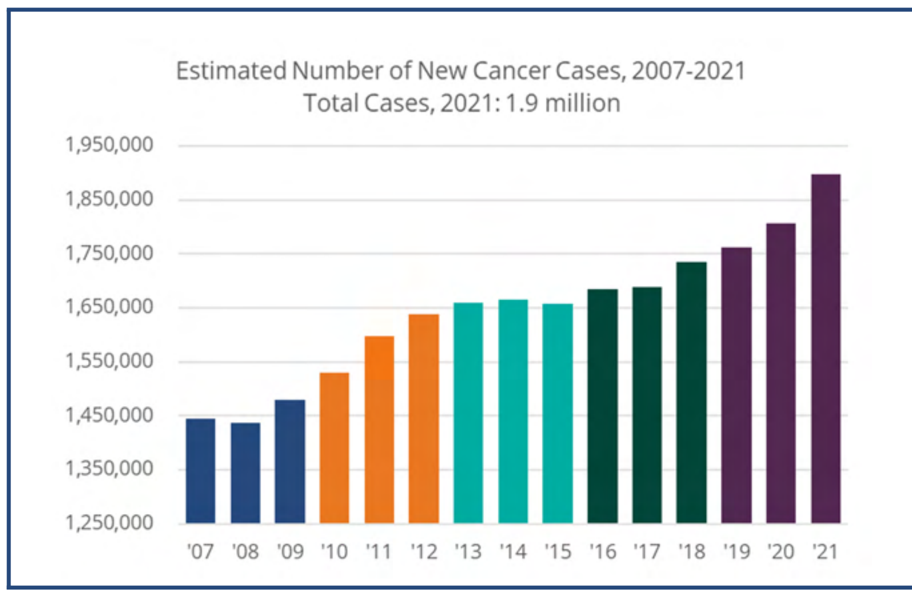
The American Cancer Society estimates that approximately 1.9 million new cancer cases were diagnosed in the U.S. in 2021. This is a 5.1% increase over 2020 and a 2.0% increase since 2010, compounded annually.

Further, according to the National Cancer Institute's Cancer Trends Progress Report, total cancer expenditures (including indirect costs) in the U.S. reached $208.9 billion in 2020 and represents a compound annual growth rate of 1.9% since 2015. This report notes indirect cancer expenditures include cancer detection, treatment, and research.

Per the 2020 Physician Specialty Data Report published by the American Medical Association, the number of oncologists in the U.S. has increased 3.0% compounded annually from 22,869 in 2015 to 24,659 in 2019. Of the total oncologists, 66.0% were hematologists and oncologists, 12.5% were pediatric hematologists and oncologists, and 21.5% were radiation oncologists.

COVID-19 & Other Trends

The COVID-19 pandemic and resulting lockdown measures in early 2020 resulted in temporary volume reductions due to delays in cancer screenings and diagnoses. Even so, new cancer cases increased 2.5% from 1.76 million cases in 2019 to 1.81 million cases in 2020, which is in line with prior years' trends. However, cancer diagnoses increased 5.1% in 2021 to 1.90 million cases. This suggested that, as had been widely feared and speculated by the oncology community, cancer diagnoses were delayed during the pandemic.

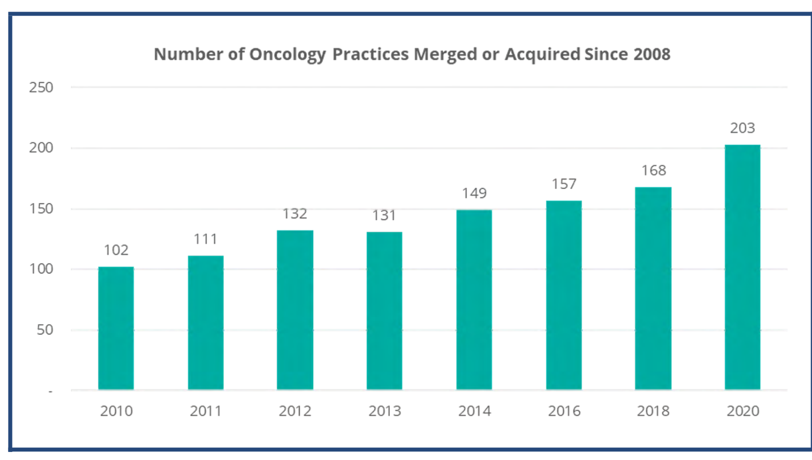


Year	YoY%	3YR CAGR
2007	3.2%	0.8%
2008	(0.5%)	
2009	2.9%	
2010	3.4%	2.3%
2011	4.4%	
2012	2.6%	
2013	1.3%	(0.0%)
2014	0.3%	
2015	(0.4%)	
2016	1.6%	1.0%
2017	0.2%	
2018	2.8%	
2019	1.6%	2.5%
2020	2.5%	
2021	5.1%	
15YR CAGR		1.8%

More lasting consequences of the pandemic include a migration toward telemedicine and outpatient services as well as the acceleration of the transition to value-based care.

In 2016, CMS initiated the Oncology Care Model ("OCM"), a five-year alternative payment model designed to improve chemotherapy care through financial and performance accountability during an episode of care. The OCM is structured

in a way that allows practices to receive an episodic payment for the total patient care. This includes non-oncology care within a six-month period that begins with a qualifying chemotherapy treatment. Originally set to expire in June 2021, the OCM model will end on June 30, 2022, after being extended a year due to COVID-19. The CMMI has not yet announced a replacement model.



As a result of ongoing reimbursement pressures, growing regulation, and increasing overhead, independent physicians are seeking alternative employment structures to private practice. According to the 2020 Community Oncology Alliance Practice Impact Report, the number of community oncology practices merging or being acquired by another practice or corporate entity, such as a PE firm, has increased by 9.9% since 2018, compounded annually. In fact, trends over the previous 10 years suggest there has been an average of 7.1% annual increase in the number of community oncology practices that have been acquired by a corporate entity and/or merged with another oncology practice from 2010 to 2020. However, more recent deal activity suggests a shift from large-scale platform transactions to tuck-in acquisitions by these platform entities as they seek to scale their businesses in both geography and size.

Private Equity

As previously mentioned, there has been a recent uptick in tuck-in acquisitions within the oncology space following the emergence of several PE-backed platforms over the past few years. These platforms strategically target practices for consolidation to leverage geographic expansion, economies of scale, or hospital affiliations.

Recent PE Investment	Platform	Locations	Providers	PE Firm	Vintage
Medical & Radiation Oncology Platforms		**500+**	**750+**		
	OneOncology	260+	726	General Atlantic	4 years
	Integrated Oncology Network	49	n/a	Kohlberg & Company	4 years
	Verdi Oncology	3	9	Pharos Capital Group	4 years
	Alliance HealthCare Services [1]	200+	n/a	Tahoe Investment Group	4 years
Urology Platforms [2]		**450+**	**750+**		
	United Urology Group	220+	95	Audax Private Equity	3 years
	Urology Management Associates (3	n/a	n/a	Prospect Hill Growth Partners	4 years
	Solaris Health	179+	500+	Lee Equity Partners	2 years
	Urology America	20+	50+	Gauge Capital	2 years
	US Urology Partners	24+	50+	NMS Capital	4 years
	Urology Partners of America	20	64	Triton Pacific Capital Partners	1 year
Grand Totals		**950+**	**1,500+**	**Average Age**	**3.2**

(1) Acquired by Akumin Inc in 2021.

(2) Urology platforms and investments considered due to radiation oncology component.

(3) Acquired by Summit Health in January 2022.

Since its founding in 2018 by General Atlantic, OneOncology has continued to expand its physician network in both size and geography. The platform, now comprised of 726 providers at over 260 sites, has acquired and expanded practices in Arizona, California, New England, Pennsylvania, New Jersey, and Texas. In February 2021, OneOncology acquired the "Central Jersey Division" of Regional Cancer Care Associates to form Astera Cancer Care, a physician-owned multi-specialty community oncology practice. The practice has over 60 oncology providers across 18 sites in New Jersey and Pennsylvania. In December 2021, Astera Cancer Care further expanded its regional footprint with the acquisitions of three New Jersey-based medical oncology practices. OneOncology targets leading community oncology practices to provide comprehensive and cost-effective cancer care. Oncologists are attracted to the platform’s business model which allows them to remain independent while expanding their services and offering advanced treatment options.

Silver Oak Services Partners led the 2018 recapitalization of Integrated Oncology Network ("ION"), a platform comprised of 57 cancer centers in 14 states. In January 2021, ION created a new multispecialty platform in the Cleveland, Ohio market with its acquisition of Southwest Urology. Most recently, ION announced its acquisition of California Cancer Associates for Research and Excellence, an integrated cancer care network that provides medical oncology, radiation oncology, diagnostic imaging, and other ancillary services in the Fresno and San Diego markets.

Growth prospects for urology practices are also particularly strong due to increases in life expectancy that have generated greater demand for urologic services. Additionally, an expected shortage of urologists estimated to exceed 3,600 providers by 2025 will only further amplify the situation. Urology’s several sources of ancillary revenue such as lab and pathology services, lithotripsy, radiation oncology, and ambulatory surgery make the specialty particularly attractive to platforms seeking to execute a roll-up strategy. With over 13,000 urology providers, 52% of whom work in private practice, this fragmented market offers PE firms the opportunity to facilitate consolidation. This prospect, paired with the strong demand for urologic services, has led to significant investment interest in this space.

One platform that has been particularly active over the past year is Solaris Health which is backed by PE firm Lee Equity Partners. This urology platform was formed in 2020 through the merger of Integrated Medical Professionals and The Urology Group. In 2021, the platform acquired six new practices in Chicago, Maryland, Colorado, Michigan, and Pennsylvania. Solaris recently announced in March 2022 it would expand its operations into Florida through the acquisition of Advanced Urology Institute, a fully integrated urology practice with 105 providers. With more than 500 providers across 11 states, Solaris offers a full suite of urology services that includes, radiology, robotics, and oncology.

Notable Deals

In June 2021, The Oncology Institute ("TOI") became the first publicly traded oncology company after it was acquired by DFP Healthcare Acquisitions Corp., a special purpose acquisition company. At the time of the transaction, TOI had a pro forma enterprise value of approximately $842 million with an implied multiple of 2.4x estimated 2022 revenue and projected 2022 EBITDA of approximately $6.0 million. As of March 2022, the company has updated its guidance for the year and now projects FY 2022 revenue of $270 to $310 million and adjusted EBITDA of ($20) to ($25) million and is citing higher than expected general and administrative expenses associated with recent growth. Since going public, TOI has continued its geographic expansion through strategic partnerships, de novo clinics, and acquisitions, such as the recent acquisition of Fresno-based Women's Cancer Care announced in May 2022.

"Scalable, replicable model with significant whitespace growth opportunities in a fragmented M&A environment."

The Oncology Institute of Hope & Innovation
March 2022 Investor Presentation

In December 2021, City of Hope announced the strategic acquisition of Cancer Treatment Centers of America, a network of oncology hospitals and outpatient centers across the United States. The $390 billion acquisition closed on February 1, 2022 and added 161 licensed beds to the City of Hope system. The combined organization will serve approximately 115,000 patients each year with 575 physicians across its California, Arizona, Illinois, and Georgia locations.

Reimbursement

Additionaly, CMS released an updated finalized rule for the 2022 MPFS, which included a 0.82% cut from the 2021 conversion factor.

On November 2, 2021, CMS issued a final rule regarding the Alternative Payment Model ("APM") for radiation oncology ("RO"). The RO APM establishes a bundled, site-neutral, episode-based payment for all radiation therapy services provided in a 90-day episode of care. Under the finalized APM model, the number or type of fractions delivered will no longer impact payment, and only the specific disease site will be treated. Providers will be paid a fixed rate depending on the patient's cancer type that would cover most of the course of radiation therapy services provided including consultation, treatment planning, dose planning, radiation physics and dosimetry, treatment devices and special services, treatment delivery, and treatment management. The start date of the RO APM was delayed from January 1, 2023, to a date to be determined through future rulemaking.

A 2018 final rule by CMS reduced the payment rate calculation for hospitals within the 340B program by 29%, or 106% of the average sale price to 77% of the average sale price for most Part B drugs. Since their implementation, the reimbursement cuts have been challenged throughout the court system. After hearing oral arguments in November 2021, the Supreme Court is expected to issue a ruling on the topic later this year.

Conclusion & Future Outlook

While the oncology industry has continued to trend toward consolidation, there has been a shift from large, platform transactions to tuck-in acquisitions due to existing platforms focusing on growth through strategic partnerships with practices and physicians. Nonetheless, the oncology market remains fragmented and poised for continued consolidation. Oncologists continue to seek alignment with larger organizations to hedge against financial uncertainty and provide the capital necessary to fund technology infrastructure related to risk-based contracting and other value-based arrangements. In addition to the opportunities associated with continued consolidation, it is likely there will be recapitalizations of the private equity-backed platforms over the next few years, given the age of several platforms and typical holding periods for PE firms.

More Oncology Thought Leadership

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- Oncology Reimbursement Environment: Recent Changes, Impact and Outlook

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